

CONSUMER PERSPECTIVES ON ENERGY POLICY

HEARING

BEFORE THE

SUBCOMMITTEE ON ENERGY AND AIR QUALITY

OF THE

COMMITTEE ON ENERGY AND
COMMERCE

HOUSE OF REPRESENTATIVES

ONE HUNDRED SEVENTH CONGRESS

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CONTENTS

	Page
Testimony of:	
Anderson, Mahlon G., Director, Public Affairs, American Automobile Association Mid-Atlantic	34
Buckley, Glen N., Chief Economist and Director of Agribusiness, CF Industries, Inc	38
Cook, John, Director, Petroleum Products Division, Energy Information Administration, U.S. Department of Energy	7
Duke, John, National Director, Facilities Management, Kmart Corporation	43
McCutchen, J. Mark, President and General Manager, Tennessee Energy Acquisition Corporation	22
Ottenberg, Lee, President, Ottenberg's Bakery, accompanied by Phil Holcraft, Purchasing Manager	16
Parkel, James G., President Elect, American Association of Retired Persons	18
Material submitted for the record by:	
McCutchen, J. Mark, President and General Manager, Tennessee Energy Acquisition Corporation, letter dated May 16, 2001, enclosing material for the record	69

CONSUMER PERSPECTIVES ON ENERGY POLICY

TUESDAY, MAY 15, 2001

HOUSE OF REPRESENTATIVES,
COMMITTEE ON ENERGY AND COMMERCE,
SUBCOMMITTEE ON ENERGY AND AIR QUALITY,
Washington, DC.

The subcommittee met, pursuant to notice, at 1:08 p.m., in room 2123, Rayburn House Office Building, Hon. Joe Barton (chairman) presiding.

Members present: Representatives Barton, Burr, Shimkus, Bryant, Radanovich, Tauzin (ex officio), Boecher, and Markey.

Staff present: Andy Black, policy coordinator; Sean Cunningham, majority counsel; Jason Bentley, majority counsel; Peter Kielty, legislative clerk; Sue Sheridan, minority counsel; Alison Taylor, minority counsel; and Erik Kessler, professional staff.

Mr. BARTON. The subcommittee will come to order. We certainly have enough members to start the opening statements. We would like all our witnesses to come forward. We would appreciate that. Looks like we are missing one. Mr. Ottenberg. Is he coming? Oh, there he is. Okay.

Today the Energy and Air Quality Subcommittee focuses on consumer perspectives on a comprehensive energy policy. Consumer demand for energy in our country continues to grow. Since 1970 when our country consumed about 80 million quads, today that number, in terms of consumption, has grown to approximately 100 million quads—a 100 million quads would be a lot. That is not true. We have consumed 80 quads of energy and now we are up to a hundred. If we were in the millions that would be quite a thing. Unfortunately, our supply growth has not matched our increased demand for energy.

Energy is not an abstract or irrelevant product. Factories can not make products without energy, our transportation sector cannot move products without energy, utilities cannot make electricity without energy, and individuals cannot heat or cool their homes or apartments without energy. If we have a shortage in the production or transmission of energy, our Nation has a problem. So we can stipulate today that our Nation has a problem.

On the other hand, Americans are very sensitive about increases in energy prices. We regularly check the price at the pump and the local gasoline station; I paid \$1.73 a gallon this morning in Virginia when I filled up, but I also noticed very quickly when I paid the final price, it was \$28 to get a tank of gasoline. That is a lot of money.

The cost per kilowatt hours of our electricity bill is in the million BTU cost of our gas bills. Most Americans check the price of energy more frequently than they check the Dow Jones industrial average. High costs increased the cost of production, which causes inflation, which causes unemployment, which causes heartburn for the American worker. High energy costs decrease personal disposal income, which hurts all individuals as well as the economy in general.

Today we will have our consumer hearing. I want to welcome all of our witnesses here. We appreciate you coming to Washington today. Your insights are going to be very helpful to the subcommittee as we begin to mark up a comprehensive energy policy later this month or next month. It is easy to get lost in the politics of Washington, but no one should lose sight of why we are here, and why we need to establish a sound, comprehensive energy policy for the country.

Day after tomorrow, on Thursday, the President of the United States will announce his general plan. And much of it will call upon this subcommittee to work. I look forward to working with the President, the Vice President, and members on both sides of the aisle, to work with the President to put together a comprehensive energy policy on a bipartisan basis.

I happen to come from a State that produces a lot of energy. We send natural gas crude oil and refined products throughout the country and the world for consumption. Increasingly, we are using more alternative energy such as wind energy and solar energy in our supply mix. Texans have many reputations, some of them are appropriate, some of them are not. Some Texans are being characterized as trying to reform energy policy simply to help energy producers. That misses the point. Make no mistake, Texans are for a comprehensive energy policy, they are also for energy policy that helps consumers. Because one of the little known secrets about Texas is that Texas is a net importer of energy. That would just absolutely stun probably 80 percent of the people in my State, but we import tremendous amounts of coal to fuel our electricity generation system in Texas.

So if Texas is a net importer of energy, it tells you that there is probably no State in the union that is a net exporter of energy. So no State is immune for the need to improve the supply demand balance, just as no great Nation can afford to remain as dependent as we are upon foreign imports, which are currently over 30 percent. Energy needs to be both plentiful and at an affordable cost if we are going to have the kind of economy that all of us want. Today's hearing should give us an insight in how to develop that economy.

With that, I would like to recognize the ranking Democrat on the subcommittee, the Honorable Rick Boucher of Virginia for an opening statement.

Mr. BOUCHER. Thank you, Mr. Chairman. I welcome the testimony of our witnesses this afternoon on the effects on the Nation of high energy prices. Recommendations from the witnesses of consumer friendly changes in national energy policy will also be welcome. I am particularly interested in an examination of the causes underlying the recent sharp increases in gasoline prices. And I welcome the testimony, particularly today of Mr. Cook, who is the di-

rector of petroleum products at the Energy Information Administration. He is well qualified to offer guidance on this matter of concern to all motorists. Perhaps in his testimony, Mr. Cook can shed light on what is a seeming contradiction. Oil industry spokesmen say that refineries can barely keep pace with the demand for gasoline, but on May 2, the EIA reported that gasoline stocks have increased as production and the importation of refined products have outpaced demand.

Our stock, in fact increasing, are they outpacing demand? And if this is true, what does that fact say about the much-discussed shortage of refinery capacity?

Another alleged culprit lead together higher gasoline prices is the practice of tank drawdown in which a storage tank is emptied of one blend of gasoline before a new blend is added. Drawdowns occur between January and April in most years because refineries generally ensure that they have only summer blends in the tanks by May 1. The retail industry, in turn, empties its tanks to achieve a storage of summer blend by June 1.

Complete tank drawdowns are blamed for short gasoline supplies. But are these complete drawdowns really necessary? The EPA claims that refineries and retail operations are permitted to commingle winter and summer blends of reformulated gasoline, gradually replacing one with the other. If the EPA is correct, and commingling is consistent with the reformulated gasoline rules, why is the complete drawdown practice pursued? Some suggest it is pursued solely for the purpose of increasing the price of the product. Any comments of Mr. Cook and the other witnesses on these matters relating to high gasoline prices will be most welcome.

I am also interested in the comments of our witnesses on the affect of high prices for natural gas and electricity on businesses and residential consumers nationwide. And I would invite our witnesses to make any observations they may care to share with us on other matters that the committee is considering, including the special problems affecting energy markets in the Western States and the energy policy recommendations that the administration is scheduled to release later this week.

Thank you very much, Mr. Chairman for inviting these witnesses to discuss these matters and I look forward to their testimony.

Mr. BARTON. Thank you, Congressman Boucher. I now recognize Mr. Bryant of Tennessee for an opening statement.

Mr. BRYANT. Thank you, Mr. Chairman, for convening this hearing. I very much appreciate the nature of this hearing and the nature of the very qualified witnesses that we have to appear before us today that bring a different perspective in some cases than what we oftentimes hear.

On Thursday, the Bush Administration Energy Task Force will unveil their recommendations for a comprehensive national energy policy. And I believe it is important that this subcommittee hear their perspectives of the consumers that we are just talking about on this panel in regard to this energy policy as particularly as we move forward with the President's proposals. Rolling blackouts in California have grabbed all headlines lately, but our Nation's energy problems have affected most other parts of the country as well. I know municipal utilities in my Tennessee district saw the

cost of natural gas surge nearly \$10 per million BTUs on the spot market over the winter. Consumers cannot afford to pay these prices, and the Nation's economy cannot absorb these types of increases. I know personally, as a consumer, I saw my prices increase dramatically and my constituents and many, many people were really hurt in this situation.

I could afford to pay my bill, that was $2\frac{1}{2}$ times what it normally was, but my concern were those folks out there who really, really could not pay those bills. And in many cases those expenses were absorbed by utilities by the gas department people that were trying to help. There is some Federal funds out there that helped out. But across the board, I think everyone was hurt by this.

And in the end, there was a lot of money out there that went into some folks' pockets. And I think we need to hear a little bit more about that. And because of that, I have, outside of this hearing, asked for General Accounting Office investigation of this. That was primarily at the request of one of our witnesses today. And the folks he represents in my district, Mr. McCutchen, who I think is going to bring some very good testimony before this panel. And I urge everyone to listen carefully to what he has to say. I think he is imminently qualified to talk about this subject, and certainly something that we ought to look at and we have ultimate responsibility, not only for oversight and to find out what happened, but if things did happen that shouldn't have happened, we need to correct those things before next winter. People cannot afford to pay those kinds of bills to keep their places warm, and you can only wear so many sweaters and pairs of socks and try to stay warm.

I believe, getting back to my statement, I believe that President Bush is right in his efforts toward developing a national comprehensive energy policy. However, before the legislation is drafted, we should fully understand what causes these kinds of problems, and specifically today, I would like to talk about natural gas. But along with the other 13 Members of Congress who have asked for this GAO investigation on national gas prices, I am confident that a result will come from that, and we need to move them along and get them moving toward a finality in their investigation. So again, we can have some results on which to take some actions if necessary before this winter's prices go back up.

In closing, many times in Congress we rely on information from inside-the-Beltway-type experts to keep us informed and to tell us what is right and wrong about this, and this hearing I think is important because it gives us members and opportunity to hear the perspective of the consumers, the people that are outside the Beltway a little bit.

So that is why I am pleased to be here today. I had a speech this morning to the distributors of my TVA power back in my State in Nashville. Early morning I had to jump a plane and run to the airport and grab a cab and fly very quickly from Atlanta to BWI and drive through traffic jams to get here, but I made it by 1 because I wanted to be here for my constituent, whose vote I will probably solicit in another year or so. I will introduce my constituent in more length in just a minute. I yield back the balance of my time and thank the chairman for this hearing.

[The prepared statement of Hon. Ed Bryant follows:]

PREPARED STATEMENT OF HON. ED BRYANT, A REPRESENTATIVE IN CONGRESS FROM
THE STATE OF TENNESSEE

Mr. Chairman, I commend you for holding today's hearing. On Thursday, the Bush Administration Energy Taskforce will unveil their recommendations for a comprehensive national energy policy. I believe it is important that this subcommittee hear the perspectives of consumers on energy policy as we move forward in the coming weeks on the President's proposals.

Rolling blackouts in California have grabbed all the headlines, but our nation's energy problems have effected most other parts of the country too. Municipal utilities in my Tennessee district saw the cost of natural gas soar to near \$10 per million Btu's on the spot market over the winter. Consumers can not afford to pay these prices, and the nation's economy cannot absorb these types of increases.

Natural gas consumption has grown nationwide, and many national experts say that the high prices can be attributed to low storage supplies. In March, I was informed by managers of publicly owned natural gas distribution systems in my district that the cost of producing natural gas has not substantially increased and even on the coldest days of the winter, there was no shortage in natural gas. It seems the conventional wisdom that these drastic price increases are the result of supply and demand seems to be contradictory to what my constituents have reported.

I believe President Bush is right on the money in his efforts toward developing the framework for a comprehensive national energy policy. However, before legislation is drafted in the House, we should fully understand what caused the seemingly unexpected increase in natural gas prices. I, along with thirteen other Members of Congress, have been granted an investigation by the General Accounting Office into the causes of natural gas price increases. I hope the results of this investigation will help shed light on whether we are facing a natural gas supply and demand problem, a case of market manipulation by large gas marketing companies or both.

In closing, many times in Congress, we rely on the information of so-called "Inside the Beltway" experts to keep us informed about what is wrong in the country, and they're not always right. This hearing is very important because it gives Members an opportunity to hear the perspectives of the consumers who are out there dealing with our nation's energy problems everyday, not sitting in a cubicle on K Street far removed from reality. I look forward to hearing from this panel and getting their input on national energy policy and again, I commend the Chairman for conducting this very important hearing.

Mr. BARTON. I appreciate that. The gentleman from Illinois and his assistant are recognized for an opening statement.

Mr. SHIMKUS. Thank you, Mr. Chairman. Let me introduce Daniel Shimkus. He has been in hearings before last year in the consumer protection subcommittee.

You can't talk.

He was trying to tell Congressman Bryant to be quiet and quit rambling on, but Congressman Bryant was not paying attention. But you know, we have been—people ask me what is going on in Washington and bottom line, other than that music playing in the background, you know, energy for us on this committee and as a Nation as a whole is a No. 1 issue that I am going to be dealing with the rest of this year and all next year. And we are excitedly waiting for some of the President's proposals. I believe in basic economics. I believe in supply and demand. I tell my consumers and the American public time and time again, if you want cheap electricity, you have to generate it. If you want low gasoline prices, you have to produce it. You can't have both. The public is still a little conflicted when we see Tacoma, the city council, trying to ban hot tubs and the people pressuring them not to do that.

We—I have Wal-Mart in Chicago land area that wants to open a low cost gasoline provider, the citizenry pushes the county board to vote it down because they are afraid of the long lines that will be generated by all the people seeking low cost gasoline. It is great to have you all here. I know testifying will be Mr. Ottenberg with

the bakers. They were just in my office. It is important for us to remember how the cost of goods and services get passed on and the cost of doing business; and that this is not just a brownout/blackout situation for California. What this does is rob our citizenry of buying power as we have inflated costs of goods and services as prices get passed on.

I know that is what I am going to hear today. I hope we will get some good advice and counsel on the direction. I would challenge you all to go back and help us spread the word that basic economics 101 works. And that basic battles of supply and demand, irrespective of any government intrusion through regulatory aspects, is the best way to provide goods and services to the people at the cheapest cost.

That is what we plan to do in this committee with good public policy. I am positive that is what the President is going to submit to us, and working with him, we will pass an energy policy for this country that will keep us—it will strengthen us on the national security, and then it will have our current fuels, renewable fuels, research and development and other important things to have a broad national energy policy.

I look forward to the hearing. I am sorry for the intrusion of my son, but I can't help showing him off. But I look forward to the hearing. I yield back, Mr. Chairman, the balance of my time.

Mr. BARTON. We appreciate that. We appreciate your assistant being here today. Did he just move to adjourn? Congressman Bryant has a witness from his district and we would give him an opportunity to introduce that witness before we begin our witnesses.

Mr. BRYANT. Thank you, Mr. Chairman. Without being up staged by my colleague's son to the right who, Daniel, I think, he is ready to bust out in song at any minute. Here I will introduce Mr. McCutchen, who is, as I alluded to earlier one of my voters in my district. He is also from the city of Clarksville, the largest city that I represent in the 7th District. And he has been active in the area of energy and power for a number of years, graduated from the university there at Austin Peay University in Clarksville, and has worked with the city and is now with the Tennessee Energy Acquisition Corporation, which is a nonprofit, not-for-profit company that arranges the supply and distribution of natural gas to some 15 customers, cities and counties and communities, many of which—most of which, I should say, are in my district. And he was in my office earlier this year along with a number of city mayors and voiced this complaint, and I felt today would be a good day to give it more sunshine, and I am pleased to have Mr. McCutchen testify. Thank you, Mr. Chairman.

Mr. BARTON. We appreciate your providing the witness for us, Congressman. We are going to start with John Cook, the director of Petroleum Products Division Energy Information Agency, and just go right on down the line. At most congressional hearings, Mr. Cook, as an administration or executive branch witness, would be on a panel by himself, but we asked if he would sit with our private sector panelists to kind of expedite the hearing. We appreciate your acquiescence to that. So we will give Mr. Cook as much time as he wishes because he has been asked some fairly specific ques-

tions about the gasoline supply and demand situation in the country.

And then when we get to Mr. Ottenberg, we will give each of you 7 minutes to—or 5 to 7 minutes to summarize your testimony, and then we will have questions.

So Mr. Cook, we welcome to you the subcommittee again. Look forward to your insightful testimony. Your statement is in the record and we would give you such time as you may consume to elaborate on it.

STATEMENTS OF JOHN COOK, DIRECTOR, PETROLEUM PRODUCTS DIVISION, ENERGY INFORMATION ADMINISTRATION, U.S. DEPARTMENT OF ENERGY; LEE OTTENBERG, PRESIDENT, OTTENBERG'S BAKERY, ACCOMPANIED BY PHIL HOLCRAFT, PURCHASING MANAGER; JAMES G. PARKEL, PRESIDENT ELECT, AMERICAN ASSOCIATION OF RETIRED PERSONS; J. MARK MCCUTCHEN, PRESIDENT AND GENERAL MANAGER, TENNESSEE ENERGY ACQUISITION CORPORATION; MAHLON G. ANDERSON, DIRECTOR, PUBLIC AFFAIRS, AMERICAN AUTOMOBILE ASSOCIATION MID-ATLANTIC; GLEN N. BUCKLEY, CHIEF ECONOMIST AND DIRECTOR OF AGRIBUSINESS, CF INDUSTRIES, INC.; AND JOHN DUKE, NATIONAL DIRECTOR, FACILITIES MANAGEMENT, KMART CORPORATION

Mr. COOK. Thank you, Mr. Chairman, and members of the subcommittee, for the opportunity to testify today. Gasoline prices continue to climb setting a new record and yesterday—

Mr. BARTON. Mr. Cook, would you suspend. We just had the full committee chairman arrive, and since we haven't yet, would you like to give a brief opening statement, Mr. Chairman, before we begin to hear the testimony.

Chairman TAUZIN. I don't want to interrupt your proceeding. I simply wanted to participate in it. Rising gasoline prices across the country are indeed beginning to trouble consumers, and understanding what this market is doing and the reasons for these rises, these increases has been the subject of our committee hearings last year, and again this year. We are particularly concerned about the effect of fuel requirements on specific areas of the country, what it has done to the national market, and how it is impacting consumers.

Most people don't realize, Joe, is that you and I represent two of the greatest oil and gas producing States of America. We are also among the top per capita consumers of energy. And when there were long lines in this country, some of the longest lines were in Texas and Louisiana. And when there were shortages, we felt it on the natural gas pipelines as much or more than anyone else in this country. So we have a huge consumer interest in making sure that our markets work and that our policies do not cause higher prices and cause shortages but actually help prevent them.

And so the effect on consumers and what is likely to happen in the next few months as we begin to look at the President's package on energy is very important. So this hearing is critically important.

Mr. Chairman, again, I want to thank you for calling it. I don't want to interrupt it any further. I want to hear from the witnesses. Thank you sir.

[The prepared statement of Hon. W.J. "Billy" Tauzin follows:]

PREPARED STATEMENT OF HON. BILLY TAUZIN, CHAIRMAN, HOUSE COMMITTEE ON ENERGY AND COMMERCE

I would like to thank Chairman Barton for holding this hearing. Few things affect American consumers like high energy prices. We all tend to take energy for granted when it is abundant and prices are low. It is inexcusable, however, to not plan for our Nation's long term energy needs. The high prices and shortages we are now experiencing are the result of a lack of investment in infrastructure, ever changing regulatory regimes and new demand.

Last summer, high gasoline prices in the Midwest had the previous Administration alleging "market manipulation" by so-called "big oil." They ordered an FTC investigation. While the allegations were widely reported, the findings were not. The staff found **"no evidence of illegal collusion to reduce output or raise prices."** In fact, the report found the causes of the price spikes were beyond the control of the industry participants, and attributed them to lack of refinery capacity and pipeline failures.

Similarly, last week, the FTC completed an almost 3-year investigation into Western gasoline prices. In a 4-0 decision, the Commission discovered no evidence that any refiner had the ability to profitably raise prices market-wide or reduce output at the wholesale level. The problem, as it turns out, is not "big oil." The problem is that demand has grown, and our Country no longer has the infrastructure to support our energy needs. Nor do we have sufficient supplies of affordable energy. But while our regulatory agencies have not found any industry misconduct over the past year, I hope they remain vigilant and enforce our nation's laws to ensure that *illegal conduct to manipulate prices* does not occur.

Already, gasoline prices across the country are averaging \$1.70 per gallon. In the Midwest and California, it is \$2.00 per gallon and climbing higher. Gasoline prices at the pump this summer may reach \$3.00 per gallon in some parts of the Country. Natural gas prices are projected to be above \$5.00 per million Btu for this year. In some parts of the country, it is expected to be much higher. It is unclear yet how high natural gas prices will affect the economy. The average price for residential customers so far this year is averaging nearly \$10 per thousand cubic feet—last year it averaged \$7.71, the year before that, \$6.69. The cost of natural gas for utilities this past December averaged \$8.25 per thousand cubic feet. Normally, it's around \$2 to \$3. The price is not expected to go down any time soon. While high-energy prices have some effect on our economy, they certainly impact every household and every energy consumer. This hearing is designed to hear from consumers in all facets of life throughout the United States.

While it is not yet clear the impact these high prices are going to have on our Nation's economy, what is clear is that we must not allow this situation to repeat itself. To avoid future supply disruptions, this Committee will work with the President to produce a comprehensive national policy that addresses all sources and uses of energy.

I look forward to hearing the testimony of our witnesses today. I would like to take a minute to introduce one of our witnesses, Mr. Glen Buckley from CF Industries. CF Industries is a farmer owned cooperative that operates a fertilizer manufacturing facility in my district. Mr. Buckley will testify today about the impact high natural gas prices have had on the price of fertilizer, and how that is affecting American farmers. I welcome him, and look forward to hearing what he and the other witnesses have to say. Thank you.

Mr. BARTON. We have now been joined by Mr. Burr. Would Mr. Burr wish to give a brief opening statement before we begin Mr. Cook's testimony?

Mr. BURR. Mr. Chairman, very brief testimony, I apologize to the testimony. I spent the last 30 minutes in my office reading the testimony of the energy information testimony because their testimony didn't come in until 12. Mr. Chairman, while you are here and while the chairman of the full committee is here, I hope that we will find a way to convey to our witnesses that testimony either

comes in on time or people don't have an opportunity to enlighten us with their great knowledge. It is impossible to prepare to intelligently ask witnesses questions about issues that are of vital importance to us as we mold and shape policy.

I can't think of anything more pressing than what we get ready to do as it relates to a long-term energy policy in this country. And when we have an arm of the Department of Energy that can't prepare their testimony, then they should enjoy the opportunity to come before us and for us to ask some very tough questions about who wrote it, who had to check off on it, who contributed to it, because we need to find out whose work it is. I thank the chairman for his indulgence I yield back.

Mr. BARTON. Well, let me add some light to that. I think Congressman Burr is exactly right, that our administration witnesses need to get their testimony in this on time. In this circumstance, the culprit is not just the Department of Energy. I think we have to—if we are going to chastise Mr. Cook, who is a civil servant, we ought to chastise the director of OMB, because my understanding is that it was held up at the Office of Management and Budget. And that is a perennial problem that we have.

Mr. BURR. I appreciate the chairman's clarification. This is not a shot at this administration or any specific agency, it is a consistent problem that we have with witnesses out of the Federal Government. Mr. Chairman, if we are going to have rules that allow us the opportunity to review testimony, to understand it and to ask questions that clarify their position, then regardless of who it is, I think they owe us the courtesy of sharing that testimony with us sooner than an hour before the hearing.

Mr. BARTON. I agree. We went through this with the Clinton-Gore Administration, and we finally got them where they were getting it in 5 the day before. We are now working with the Bush-Cheney Administration, and we have got to reteach them. It is obvious that this is an ecumenical problem, it is not a partisan issue that all administrations drag their feet. So I assure the gentleman from North Carolina that at the appropriate time, and that is sooner rather than later, Secretary of Energy, Mr. Abraham, and the director of OMB, Mr. Daniels, and the administrator at EPA, Governor Whitman, they will all be encouraged to do what you just said. You have got my word on that.

Mr. BURR. I thank the chairman.

Mr. BARTON. If necessary it will be tougher rather than nicer. But we are going to start out nice.

Now, Mr. Cook once again, good man that you are, we welcome to you the subcommittee. Your testimony is in the record and we would ask that you inform us of its contents in such time as you may consume.

Mr. COOK. Thank you, Mr. Chairman. I do apologize for the tardiness of this testimony. We can only say that we will try to do better the next time. As was noted earlier, gasoline prices continue to climb setting a new record yesterday on EIA's survey, as the national average, climbed to \$1.71 a gallon, up 31 cents in the last 7 weeks. Some regions have experienced even greater increases. Again, this year, midwest consumers are seeing some of the highest prices and largest increases. Prices in the midwest averaged \$1.81,

up 43 cents a gallon. Most of the factors that affected prices last year are again at work this year, namely, relatively tight crude oil markets resulting in low inventories, unique regional and seasonal products, high refinery capacity utilization and dependence on distant supplies. When these factors come together as they did last year, and again this spring, the risk of rapid price runups increases.

To expand briefly on inventories, low stocks set the stage for the current situation this year just as last year. Low inventories originate in the tight global crude balance that evolved in early 1999. Arguably, this tightness has been a key factor in maintaining low inventories since then. Actions taken by OPEC and several other crude-exporting countries are largely responsible for the sharp increase in oil prices from the \$10 low seen in December 1998. OPEC dramatically reduced crude production in 1998 and again in early 1999, so much so that even after four increases last year, inventories remained at low levels.

Furthermore, up until the last several months, scarce crude supplies have encouraged high near-term prices relative to distant deliveries. This situation, known as backwardation, tends to discourage inventories as well. Thus with currently low crude and product inventories, little cushion exists to absorb unexpected imbalances in supply and demand, setting the stage for volatility. Although global demand is projected to continue growing this year, OPEC's current plans, announced plans, imply even less production this year than last year. In view of this, it is expected that global inventory growth will remain minimal this summer when stocks normally build and crude oil prices would return roughly to the \$30 level.

Turning to the United States and to gasoline inventories, we see them again this spring very low, indeed even lower than last year, some 4 percent below the seasonal 5-year average. Midwest stocks are even lower still, almost 10 percent lower than their 5-year average. Furthermore, both conventional markets and reformulated gasoline markets, or RFG markets, show low stocks. Such low inventories are partially a consequence of refineries focusing strongly this past winter on distillate production given that the U.S. entered the heating season with very low inventories. They are also a consequence of high natural gas prices, which encouraged fuel switching to distillate and reduced the production of key clean gasoline components, including MTBE. But there are several other factors that are also at work, adding to the potential for volatility when stocks are low. Today's gasoline market is comprised of many different types of gasoline that serve different regional markets with varying environmental requirements.

While producing specialized products for only those areas with air quality problems is seen as an efficient means of producing clean air, this increase in product types adds a level of complexity to the production distribution and storage of gasoline. The result of this targeted approach has been to create gasoline islands. The primary examples, of course, are California and the Chicago Milwaukee areas, in which these required gasolines are not only unique, but a limited number of refineries make these products.

Thus, when gasoline inventories in these regions are drawn down rapidly in response to supply problems, gasoline prices tend to surge, even if other gasoline markets are not tight, even if other areas experience a surplus, these price surges may be extended since the specialized fuels cannot be quickly resupplied.

Refinery capacity limitations have also become a factor affecting the gasoline market, especially during periods of low inventories. The summer of 1997 was the first time the U.S. refining system was pushed to its practical operating limit and was unable to respond adequately to unusually high gasoline demands. As a result, seasonably low inventories were rapidly depleted and prices surged. Since then, capacity has grown slightly more than demand, but nevertheless remains tight in the summertime.

With little inventory to cover supply/demand imbalances and many refineries running at their practical limits, any supply problems, such as outages, can not be resolved quickly. This increases the time required for resupply and both increases both the height and the duration of any price spike. Furthermore, even if oil market conditions ease later this summer, lack of excess refining capacity may impede the system's ability to recover quickly from low stocks.

Thus, if local inventories and local refineries can not respond adequately to a temporary shortfall, extra product has to come from different sources. The cost, capacity, reliability of logistical systems as well as the travel time for movement of new supply can all impact the total time needed for adequate supply levels. For example, travel time alone can be 2 to 3 weeks for product to move from the Gulf Coast to the upper midwest. Distance and lack of pipeline connections have always been a factor affecting California markets, and last year problems with the Explorer Pipeline which brings product from the Gulf Coast to the midwest helped propel prices upward there.

This year we are again seeing what can happen when low inventories combine with regional capacity limitations and unique gasoline requirements. First, the midwest's shutdown of the Blue Island refinery created a level of concern about RFG supplies in the Chicago area. The closure also created the need for greater volumes to move from the Gulf Coast to the midwest. Economic incentives to build inventories were further eroded as Gulf Coast prices surged in response to strong demand, not only from the midwest, but also from the west coast; in addition, even the east coast, where refineries are undergoing extensive maintenance.

During April, with little inventory cushion in place, the transition from winter to summer grade gasolines in the midwest required running tanks down. This further undercut stock levels, and just as tanks were beginning to refill, Tosco's Wood River refinery had a fire reducing its ability to produce both reformulated gasolines and conventional products.

While east coast prices have not surged as much as the midwest, the east coast has endured extended refinery maintenance. In addition, several foreign refineries that are key suppliers of reformulated gasoline to the east coast have had extended outages.

Finally California typically sees price surges in the spring and summer due to its tight supply balance, the unique nature of its

gasoline and its distance from other supply sources. This spring has been no exception.

To close on a positive note, we may have just passed through what is usually one of the tightest times of the year for gasoline markets. This is the period when gasoline demand begins to rise seasonably, and yet refineries are still winding up their seasonal maintenance.

Nevertheless, production has jumped almost 700,000 barrels a day in the last several weeks. This puts refineries pretty close to full capacity. The Wood River refinery should be fully operational shortly, and barring further major refinery problems, we may see prices peaking shortly, indeed even by the Memorial Day kickoff to the summer driving season.

Our latest forecast shows monthly average prices, not weekly prices, but monthly average prices peaking somewhere between \$1.65 and \$1.75 this month. Nevertheless, we must caution that with inventories likely to remain low and given the other factors that we discussed above, markets will remain exposed to volatility, especially this summer. That concludes my testimony.

[The prepared statement of John Cook follows:]

PREPARED STATEMENT OF JOHN COOK, DIRECTOR, PETROLEUM DIVISION, ENERGY INFORMATION ADMINISTRATION, U.S. DEPARTMENT OF ENERGY

Thank you for the opportunity to testify on the factors affecting gasoline and natural gas markets.

Nationally, gasoline prices averaged \$1.71 on May 14, an increase of 31 cents per gallon over 7 weeks. (Figure 1) Some regions have experienced even higher increases. Again, Midwest consumers are seeing some of the largest increases in the country. Prices in the Midwest averaged \$1.81, having increased 43 cents per gallon over the past 7 weeks. Most of the same factors that affected prices last year are again at work this year: tight crude oil markets resulting in low petroleum inventories; unique regional and seasonal products; high refinery capacity utilization; and dependence on distant supplies. When these factors come together as they did last year and this year, the potential increases for rapid price runups.

Inventories

Low petroleum inventories set the stage for our current situation, as they did last year both for heating oil and for gasoline. These low inventories originate from the tight world crude oil supply/demand balance that has evolved since early 1999. Arguably, tightness in crude markets has been the key factor driving low inventories in recent years.

Actions taken by OPEC and several other crude oil exporting countries are largely responsible for the sharp increase in oil prices from the \$10 levels seen in December 1998. OPEC dramatically reduced crude oil production in 1998 and early 1999, so much so, that, even after four production increases last year, world inventories remain at extremely low levels. Furthermore, up until the last several months, scarce crude supplies encouraged high near-term prices relative to those for future delivery. This situation, referred to as backwardation, discouraged inventory growth, and maximum refinery production. Thus, with low crude oil and product inventories, today little cushion exists to absorb changing conditions, setting the stage for volatility. Although world demand is projected to continue growing this year, OPEC's current plans imply even less production than last year, which will keep world inventories low and maintain crude oil prices close to \$30 per barrel for the remainder of the year.

Within the United States, gasoline inventories have been even lower this spring than they were last year. (Figure 2) As of May 4, U.S. gasoline inventories were about 4% below their seasonal 5-year average. Midwest inventories were even lower, ending the week almost 9% lower than their 5-year average, and 4% below last year's levels at this time. (Figure 3) Both conventional as well as RFG gasoline markets are tight this year. Such low gasoline inventories are partially a consequence of refineries focusing strongly on distillate production last winter, given that the United States entered the heating season with very low inventories.

Inventories are located near demand areas and act as a buffer for mismatches between demand and production or imports. As EIA has pointed out on numerous occasions, very low gasoline stocks, combined with a market short on crude oil, generates an environment ripe for price volatility, both during the spring and peak summer periods

Growing Number of Gasoline Types

Another factor is at work that adds to the potential for volatility when inventories are low—the growth in the number of distinct types of gasoline. Today's gasoline market is comprised of many types of gasoline that serve different regional markets to meet varying environmental requirements. While producing specialized products for only those areas with air quality problems is seen as an efficient means of cleaning the air, the increase in product types adds a level of complexity in production, distribution and storage of gasoline.

The result of this targeted approach to air quality has been to create gasoline market islands. The primary examples are California and the Chicago/Milwaukee areas, in which the required gasolines are unique, and only a limited number of refineries make the products. The inventories of gasoline used in these regions can be drawn down rapidly in response to unusually high demand or a supply problem at one of the few refineries producing the specialized products, or in one of the pipelines delivering the products. Prices for gasoline in these regions then surge. If other gasoline markets are not tight, the price surges may be limited to the specialized gasoline regions, as we have seen historically in the case of California.

Refinery Capacity Constraints

Refinery capacity limitations have also become a factor affecting the U.S. gasoline market, especially during periods of low inventories. The summer of 1997 was the first time the U.S. refinery system was pushed to its practical operating limits for gasoline production and was unable to respond adequately to unusually high gasoline demand. (Figure 3) As a result, seasonally low inventories were rapidly depleted and prices surged. Since then, capacity has grown slightly more than demand, but the capacity situation is still tight during the summer.

With little inventory to absorb a supply/demand imbalance, and many refineries running at their practical limits, any supply problems such as refinery outages may not be resolved quickly. This factor increases the time that it takes to respond to a problem and thus increases the potential for price runups and extends the time that prices will remain high. Furthermore, even if the world petroleum market begins to see more supply at some point in the future, lack of excess refining capacity may impede the ability of the system to remedy low inventory problems quickly.

Dependence on Distant Supplies

If local inventories and local refineries cannot respond adequately to a temporary shortfall in supply, extra product may have to come from a long distance away. The cost, capacity and reliability of logistical systems, as well as travel time for movement of new supply, can all impact the total time needed for adequate supply levels to reach a market, and prices respond accordingly. For example, travel time alone can be 2 or 3 weeks for product to move from the Gulf Coast to the upper Midwest. Distance and lack of pipeline connections have always been a factor affecting California markets. Last year problems with the Explorer pipeline, which brings products from the Gulf Coast to the Midwest helped to propel prices upward.

This Summer

This year we have already seen what can happen when low inventories combine with regional capacity limitations and unique gasoline requirements. First, in the Midwest, the shutdown of the Blue Island refinery created a level of concern about supply of RFG for Chicago and Milwaukee. The closure also created the need for more product volumes to move from the Gulf Coast to the Midwest. Economic incentives to build inventories were further eroded as Gulf Coast prices surged in response to strong demand not only from the Midwest and West Coast, but also from the East Coast, where refineries underwent extended maintenance. During April, with little inventory cushion in place, the transition from winter to summer grade reformulated gasoline in the Midwest required running tanks down to very low levels, removing even more inventories. Just as tanks were beginning to refill, Tosco's Wood River, Illinois refinery had a fire that reduced its ability to produce both conventional gasoline and reformulated gasoline for the Midwest.

While East Coast prices have not surged as much as in the Midwest, the East Coast has suffered from some fairly long refinery maintenance outages. In addition, several foreign refineries that sell reformulated gasoline streams to the East Coast have had extended outages. East Coast refiners seem to be returning to full oper-

ations, with EIA's weekly data showing large increases in East Coast gasoline production.

California frequently sees price surges due to its tight supply/demand balance, the unique nature of its gasoline, and its long distance from other supply sources. This spring has been no exception. In addition, some refineries could be subject to more outages than usual due to threat of electricity shortages.

We are passing through what usually is one of the tightest times of year for the gasoline market—when refineries wind up maintenance as demand is increasing seasonally. Production has increased almost 650 MB/D since the end of March as refineries ramp up to full capacity. The Wood River refinery should be fully operational shortly, and with no further major refinery problems, we may see prices peak sometime this month. Our latest forecast has monthly average prices peaking somewhere between about \$1.65 and \$1.75. However, we are projecting continued low inventories, which, along with the other factors mentioned, keeps us exposed to further volatility, particularly during summer when demand peaks.

In short, there is no single factor causing today's price surge. The root of the problem traces to still tight world crude oil markets. This tightness brings low inventories and an increased potential for volatility. But the apparent increase in volatility seen recently is not only a function of the tight crude oil market's low inventories, but also of the loss of flexibility due to refinery capacity and distribution constraints brought about by growing demand and product proliferation.

In concluding, I also wish to note that consumers are seeing high prices in other fuels as well. For example, natural gas prices, which for many years fluctuated around \$2.00-\$2.50 per million BTU's, hit \$10 per million BTU in the Louisiana spot market this past winter. New York city gate prices went over \$20 per million BTU's, and California prices rose even higher. As was the case in petroleum, natural gas storage levels had been drawn down as demand exceeded production, and prices began rising last summer. As demand surged during last winter's cold weather, prices spiked over concerns about adequate supply. Areas like New York were also impacted by constraints in pipeline distribution. Spot prices this summer are expected to average about \$5.00 per million BTU's, or about twice what we experienced two summers ago. Next year we expect the storage situation to improve somewhat, and with that, we should see a dip in average gas prices. However, in the short term, increases in production and imports will be pressed to keep pace with growing demand brought about partially by new natural-gas fueled electric generation capacity.

This concludes my testimony.

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Mr. BARTON. We thank you, Mr. Cook. We now want to hear from Mr. Lee Ottenberg who is president of Ottenberg's Bakery here in Washington. Your statement is in the record. We ask you to summarize it in 7 minutes, and welcome to the committee.

STATEMENT OF LEE OTTENBERG

Mr. OTTENBERG. Thank you, Mr. Chairman. Our bakery, we run two baking plants, one in Washington DC and one in Eldersburg, Maryland, which is about 50 miles north. We have about 275 employees and we maintain 68 routes to cover the Washington/Baltimore metropolitan areas. We also ship product through frozen distribution to the eastern third of the U.S.

Currently, we purchase our electricity from utility companies on a daily basis at their rates. Natural gas is purchased from two suppliers on annual contracts, and the transportation of this gas is paid to the utilities. Diesel fuel for our route trucks and over-the-road tractor trailers is purchased daily from various sources.

Our overall energy costs will be approximately \$300,000 greater this fiscal year, which will end this July 1, 2001. Last year was \$900,000 approximately, and we estimate this year at \$1.2 million. The largest increase in cost after adjusting for increased volume has come from natural gas followed by diesel fuel and then electricity. Based on our current contracts, natural gas will increase 67 percent from the fiscal year ending July 2000 as compared to the current year ending July 2001.

Last year, Ottenbergs had natural gas contracts ranging from 31½ cents per therm at our Eldersburg location and 50 cents per therm in Washington. This year those same costs are 57½ cents per therm at Eldersburg and 59.9 per therm at Washington. The contracts for next year have not been placed yet, but we believe

they will be slightly higher than the last contracts covering this year.

Diesel fuel costs varied from \$1.25 to \$1.47 per gallon last year and this year they have varied from \$1.51 to \$1.77. Electric has been the least volatile in energy costs. Our cost per kilowatt varied from 5.5 cents to 5.9 cents per kilowatt last year, and from 6 cents to 6.4 this year. We have done several things to try to reduce our costs or to control our risks.

Last year we only contracted for natural gas on two of four natural gas accounts. We now contract on all four. We constantly monitor prices trying not to get surprised as we did last year. And I might add that the baking business is a business that has thin margins. So this kind of an escalation in our energy costs can have a very dramatic effect on our overall profitability. So it has an effect that kind of outweighs the dollar amount when it hits the bottom line. That concludes my testimony. I thank you for this opportunity.

Mr. BARTON. Do you yield back the balance of your time?

Mr. OTTENBERG. I will.

[The prepared statement of Lee Ottenberg follows:]

PREPARED STATEMENT OF LEE OTTENBERG, OTTENBERG'S BAKERY

Currently we purchase our electric from utility companies on a daily basis at their rates. Natural gas is purchased from two suppliers on annual contracts and the transportation of this gas is paid to the utilities. Diesel fuel for our route trucks and over the road tractors is purchased daily from various sources.

Our overall energy costs will be approximately \$300,000 greater this fiscal year (last year was \$921,141 and this year is estimated to be \$1,219,000). The largest increase in cost, after adjusting for increased volume, has come from natural gas, followed by diesel fuel and then electric.

Based on our current contracts natural gas will increase 67% from fiscal year 7/1/2000 as compared to the current year. Last year Ottenberg's had natural gas contracts ranging from \$.315 per therm at Eldersburg and \$.50 per therm at Washington. This year those same costs are \$.575 per therm at Eldersburg and \$.599 per therm at Washington. The contracts for next year have not been placed yet, but we believe they will be slightly higher than the last contracts.

Diesel fuel costs varied from \$1.25 to \$1.47 per gallon last year and this year have varied from \$1.51 to \$1.77.

Electric has been the least volatile energy cost. Our cost per kilowatt varied from \$.055 to \$.059 last year and from \$.060 to \$.064 this year.

We have done several things to try and reduce energy costs or control our risk. Last year we only contracted for natural gas on two of four accounts. We now contract on all four accounts. We constantly monitor prices so we do not get surprised like we did last year.

Commodity	YE 7/01/00	YE 6/30/01	% Inc
Natural Gas	\$263,472	\$440,000	67
Electric	\$302,926	\$366,000	20
Diesel Fuel	\$354,743	\$413,000	16
Natural gas-per therm	\$.315	\$.575	82
	\$.50	\$.591	18
	various	\$.599	
Electric-per kilowatt	\$.055	\$.060	9
	\$.059	\$.064	8
Diesel Fuel-per gallon	\$1.25	\$1.51 Low	20
	\$1.47	\$1.77 High	20

Mr. BARTON. You are an unusual witness. It is usually the opposite that you need more time. I understand you have the purchasing manager for energy from your company with you today.

Mr. OTTENBERG. That is Mr. Phil Holcraft, who is here with me. He is much better able to answer some specific questions about our effort to contract effectively for our energy costs.

Mr. BARTON. So when we get to the question period we may ask some questions that you can then refer to him. But we appreciate you and he being here. We now want to hear from Mr. James Parkel; is that correct, who is the president-elect of a small struggling group called the American Association of Retired Persons better known as AARP, which I am now eligible.

STATEMENT OF JAMES PARKEL

Mr. PARKEL. I hope you are a member.

Mr. BARTON. I am not yet a member.

Mr. PARKEL. We will fix that before we leave.

Mr. BARTON. I refuse to think I am that close to retirement. The voters may have another opinion. Anyway, your testimony is in the record. We ask that you summarize in 5 to 7 minutes.

Mr. PARKEL. Thank you, Mr. Chairman and members of the committee. My name is Jim Parkel, and I am president-elect of AARP. We thank the Chairman Barton and the other members of the committee for inviting us to present our views on how the lives of residential consumers have been impacted by the energy costs.

Beginning last fall in San Diego with electricity and continuing through the winter in the northeast where I am from is home heating oil, and now capturing the attention of millions across the country, the availability and cost of energy products have become a real concern for all Americans. AARP's over 34 million members have a vested interest in assuring that energy products are readily available for consumption and that prices that are just, reasonable and affordable.

For everyone, electricity is a basic necessity of modern life. Natural gas, home heating oil are fuels that Americans rely on. The cost of these items, however, can comprise a significant portion of an average consumer's personal expenditures. Older Americans are particularly vulnerable to rapid increases in energy prices. Although older persons consume approximately the same amount of residential energy that a non-elderly American does, they devote a higher percentage of their total spending to residential energy. Among low income, older families, an average of 23 percent of their income is spent on residential energy. Too often low income older persons are faced with a choice of risking their health and comfort by cutting back on energy expenditures or reducing spending on other basic necessities.

AARP does not consider this to be a viable option. Therefore, we have approached our views on the energy issues with two clear goals in mind: Energy sources must be there, but they must be reliable and they must be affordable. In the testimony we have submitted for the record, we have outlined some of the concerns we have with the electricity situations in California and New York.

We have discussed how California's effort to restructure the industry has altered lifestyles for residents of California and neighboring States, and even created economic havoc for consumers as far away as my home State of Connecticut. We also provided details regarding correspondence. We have sent to FERC supporting

the temporary adoption of cost-based rates. Recently, FERC chose a variation of that recommendation, that is a small step in the right direction.

Additionally, Mr. Barton, we are working to enact legislation that may provide—you are working, excuse me, to provide legislation enacted that will provide some relief to Californians in the short term until a more comprehensive approach to energy policy may be adopted. Those efforts and your visits to California to assess the situation showcase your commitment to this issue, and we applaud you for this.

AARP fears that the matters may get worse, and that swift action to meet these immediate needs must be taken. AARP's energy concerns are not just confined to electricity. Spikes in natural gas prices have caught many, many residents off guard. The price increases have obviously struck hardest at low income consumers. But even middle class residents have been forced to significantly alter their budgets to pay rising utility costs.

An AARP member from Sacramento tells us that her November and December natural gas bills increased over 100 percent from 1999 to the year 2000, and that, in fact, her January bill rose from \$61 to \$207. That is why AARP believes it is important that this Congress evaluate our Nation's energy policy with intense scrutiny. AARP understands that the demand for energy from our members is only tied to the fact that if supply is not available from the production to the transportation and distribution of energy sources, availability is critical. Therefore, we seek a balanced approach to our Nation's energy policy that includes increasing supply without degrading the land and adversely impacting the environment. While industry must do its part to forward America's energy policy objectives consumers, our members must bear a share of that responsibility. AARP is promoting energy efficiency and conservation within its membership and subjects that a national industry energy policy do the same.

In an effort to better address some of the problems and concerns mid life to older Americans have with energy, AARP will be conducting research to identify the consumption habits of their members and Americans. We look forward to sharing that research with the committee upon its completion later this year. Specifically, energy policy should include a commitment to programs such as LIHEAP and weatherization. We recommend maintenance of the LIHEAP program and a substantial increase in funding.

The eligible LIHEAP population has grown from 23 million to an estimated 29 million consumers over the last decade. The program is particularly critical for low income elderly persons who are stuck at the bottom of the income ladder. Given the poverty at the older age is permanent, AARP, through our public benefits outreach office, has been working to inform qualified consumers about this program.

Not surprisingly, though, as energy prices continue to escalate, this program will become more critical. Coupled with the fact that the existing LIHEAP funds are inefficient and insufficient to meet the current needs, you can understand our concern. Weatherization is another necessary program that and should be part of this policy on the national energy policy. Weatherization reduces energy de-

mand problems for low income families. The funds are like preventive medicine, insuring energy-healthy homes. This is especially important for the elderly who tend to live in older, less efficient homes, where energy costs can be prohibitive.

AARP is encouraged that President Bush has proposed to increase weatherization funding, and we urge the Congress to follow through. AARP has been encouraging members who are not eligible for Federal programs like weatherization to become eligible. Doing this will make the consumer more efficient and likely lead to lower utility bills.

Mr. Chairman, we commend you for your approach to addressing the Nation's energy needs. And we appreciate the opportunity to provide our perspective. The energy problems facing America are not theoretical. They are not yesterday. They are real. The time for action is now. However, you should know that our members in California, New York, and across the country are more than willing to do their part, but are looking to Washington for direction.

Thank you very much, sir.

[The prepared statement of James Parkel follows:]

PREPARED STATEMENT OF JAMES PARKEL, PRESIDENT-ELECT, AARP

Mr. Chairman and Members of the Committee: My name is Jim Parkel and I am the President-elect of AARP. We thank Chairman Barton and the other members of the Committee for inviting us to present our views on how the lives of residential consumers are being affected by energy costs. Beginning last fall in San Diego with electricity, continuing through the winter in the Northeast with home heating oil and now capturing the attention of millions across the country, the availability and cost of energy products have become a real concern for all Americans.

AARP's membership has a vested interest in ensuring that energy products are readily available for consumption and at prices that are just, reasonable and affordable. For everyone, electricity is a basic necessity of modern life. Natural gas and home heating oil are fuels that Americans rely on. The cost of these items, however, can comprise a significant portion of an average consumer's personal expenditures. In fact, energy costs can take up as much as 5 percent of the median-income household's monthly budget. Older Americans are particularly vulnerable to rapid increases in energy prices. Although older persons consume approximately the same amount of residential energy as non-elderly Americans do, they devote a higher percentage of total spending to residential energy. Among low-income older families, an average of 23 percent of their income is spent on residential energy. Too often, low-income older persons are faced with the choice of risking their health and comfort by cutting back on energy expenditures or reducing spending for other basic necessities. AARP does not consider that a viable option.

Therefore, we have approached our views on energy issues with two clear goals in mind. Energy sources must be reliable and they must be affordable. Our testimony today will focus on areas of concern that we have and steps AARP has taken to address these concerns. Finally, we will offer suggestions as to what we hope your Committee, the Congress and the White House will seriously consider in deliberations to produce a National Energy Policy.

We start with California. Mr. Chairman, you may recall that I testified before you a couple of years ago. In that testimony, we supported the authority of the states to determine whether electric utility restructuring was in their residents' best interests. We questioned whether restructuring would end up benefiting residential consumers. In that testimony, AARP recognized a federal role in ensuring that electric service would remain reliable and affordable and that consumers would be protected from unfair and deceptive practices. That was in 1999.

Today our questions remain unanswered, as California's effort to restructure the industry has altered lifestyles for the residents of California and neighboring states and created economic havoc for consumers as far away as my home state of Connecticut. We are not here today to point fingers or relive history. Rather, AARP is looking forward to ways in which residential consumers in the Western states can feel secure that when they turn on a switch, the light bulb will shine. The series of brownouts and rolling blackouts over the past months have left residential con-

sumers uneasy. Further, the recent rate hikes and the likelihood of further increases have sent many of AARP's members scrambling to find the resources necessary to pay their bills.

The energy concerns in California and the West are not confined to electricity. Spikes in natural gas prices have caught many residents off-guard. The price increases have obviously struck hardest on low-income consumers, but even middle-class residents have been forced to significantly alter budgets to pay rising utility bills. An AARP member from Sacramento tells us that her November and December natural gas bills increased over 100% from 1999 to 2000 and that her January bill this year rose from \$61.79 in 2000 to \$207.23 this year. These types of increases are not exclusive to Californians' as millions of Americans across the country have been saddled with higher natural gas bills. However, the combination of gas and electric service increases and the actuality of power outages make California unique, for now.

AARP recognizes that the West is confronting a very complex problem that requires contributions from industry, government and the citizenry to resolve in the long-term. However, help is needed immediately to stabilize Californians' daily lives and the nation's economy. In a January letter to the Federal Energy Regulatory Commission (FERC), AARP advocated for the adoption of a cost-based rate system for wholesale purchases. We viewed it as a temporary means to stabilize the situation so that the state government, the utilities and the residents could recover while supply, pricing and transmission problems are addressed. Recently FERC chose a variation on that recommendation that is a small step in the right direction. Additionally, Mr. Barton, we understand that you are working on legislation that may provide some relief to Californians in the short term until a more comprehensive approach to energy policy can be adopted. Those efforts and your visits to California to assess the situation demonstrate your commitment to the issue and we applaud you for it. AARP fears that matters may only get worse and that swift action to meet immediate needs must be taken.

Approximately, 250 miles from here in my neighbor state of New York, a similar fate may await the residents of New York City. While reports last week signal that the supply of power to the City may not be as dire as earlier predicted, AARP is concerned that a hot summer could prove troublesome for millions of its residents. Consumers in New York have already seen their electricity bills increase since deregulation eighteen months ago. Supply problems or improper price signals could force up the cost of electricity. Last month, AARP wrote to FERC Chairman Hebert, requesting that the Commission consider adopting a cost-based auction system that would not quell the competitive marketplace, but would mitigate higher rates.

I would now like to move from a regional discussion of electricity concerns to a national look at energy policy. AARP understands that the demand for energy from our members is irrelevant if the supply is not available. From the production, to the transportation and distribution of the energy sources, availability is critical. Therefore, AARP seeks a balanced approach to our Nation's energy policy that includes increasing supply without degrading the land and adversely impacting the environment. While industry must do its' part to forward America's energy policy objectives, consumers bear a share of the responsibility. That is why AARP has been promoting energy efficiency and conservation within its' membership via its web-site and through published consumer tips and suggests that a National Energy Policy do the same. In an effort to better address some of the problems and concerns mid-life to older Americans have with energy, AARP will be conducting research to identify the consumption habits of Americans. We look forward to sharing the results of the research with this Committee upon completion.

More specifically, energy policy should include a commitment to programs such as LIHEAP (Low-Income Home Energy Assistance Program) and Weatherization. AARP recommends maintenance of the LIHEAP program and a substantial increase in funding. The eligible LIHEAP population has grown from 23 million to an estimated 29 million consumers over the last decade. The program is particularly critical for low-income elderly persons who are stuck at the bottom of the income ladder, given that poverty at old age tends to be permanent. AARP, through our Public Benefits Outreach office has been working to inform qualified consumers about this program. Not surprisingly, as energy prices continue to escalate this program will become even more critical. Coupled with the fact that existing LIHEAP funds are insufficient to meet current needs, you can understand our vigilance in this area.

Weatherization is another necessary program that should be part of a national energy policy. Weatherization reduces energy demand problems for low-income families. The funds are like "preventive medicine," ensuring energy-healthy homes. This is an especially important program for the elderly who tend to live in older, less energy-efficient homes, where energy costs can become prohibitive. AARP is encour-

aged that President Bush has proposed to increase Weatherization funding and we urge the Congress to follow-through on this initiative.

AARP has been encouraging its members who are not eligible for the federal program to weatherize as well by providing information through a variety of different sources. Doing so makes the consumer more energy efficient and likely leads to lower utility bills.

These are the most critical items to be addressed in dealing with electric utility restructuring, natural gas and home heating oil price spikes and our Nation's energy policy.

Mr. Chairman, AARP commends you for your approach to addressing the Nation's energy needs and we appreciate the opportunity to provide our perspective. The energy problems facing America are not theoretical, they are real. The time for action is now. Our members in California, New York and across the country are looking to Washington for answers. We are hopeful that the Administrations' introduction of a comprehensive National Energy Policy plan later this week will address many of our concerns and further advance the debate. On behalf of AARP, I thank you again for providing us with this forum to discuss the consumer energy concerns. We look forward to continuing our active participation in this debate to working with you in crafting solutions that will ultimately benefit not only our members, but also the nation as a whole.

Mr. BARTON. Thank you sir. We appreciate your testimony and look forward to your leadership of our organization on this issue. We will now hear from Mr. Mark McCutchen, who has already been introduced by Congressman Bryant. Your statement is in the record. We ask that you summarize in 5 to 7 minutes.

STATEMENT OF J. MARK McCUTCHEN

Mr. McCUTCHEN. My name is Mark McCutchen. I am the chief executive officer of Tennessee Energy Acquisition Corporation, which is a public not-for-profit joint action organization with 15 public gas system members in Tennessee. We buy and sell natural gas in a deregulated marketplace for the benefit of our member cities and manage their transportation and storage contracts on the interstate pipeline system. I am in the gas market every day. I am really proud to have the opportunity to be here and appreciate the invitation. I particularly want to thank Chairman Barton and Congressman Bryant.

The United States is facing an energy crisis in natural gas, but, at least so far, it is a crisis of prices, not supply. Monthly market prices for natural gas, which are deregulated, doubled during the spring and summer of 2000 and reached a peak of almost \$10 per decatherm in 2001, four times the price of that in January of 2000. Natural gas prices remained at unprecedented levels well above \$4 per decatherm.

In the entire history of the deregulated gas market until this past year, natural gas prices never reached \$4 per decatherm in any month. My experiences in the market tell me that market fundamentals of supply and demand simply do not explain the increases in prices we have experienced and which continue to this day. No one who has wanted to buy gas has not been able to buy it. There has been no shortage of supply. The only shortages have been caused by constraints of pipeline delivery capacity, not the availability of supply in the fields. The impact of these high natural gas prices have been devastating to millions of natural gas consumers. Residential consumers who need the gas to heat their homes, small businesses and industries. The cost increases have been unprecedented, enormous and sudden.

Municipal gas distribution such as those which are members of my organization, have depleted their reserves; borrowed against lines of credit; attempted to arrange private as well as public home heating bill assistance programs; established extended payment plans; and in short, have done everything within their power to attempt to absorb or soften the blow of these cost increases on their customers.

But ultimately, there is only so much they can do, and the cost increases must be passed through. Our industry cannot afford to experience another winter of prices like we experienced last year. The Nation's gas consumers and its economy has a whole cannot afford these levels of prices or another round of price spikes.

In a report on U.S. natural gas markets issued this month the EIA reports that nationwide expenditures for natural gas by consumers went up from \$105 billion in 1999 to \$134 billion in 2000, \$29 billion left the pockets of the Nation's gas users and went into the coffers of a relative handful of energy companies. And 2001 has been worse than 2000. Have gas consumers been gouged? You bet. Production costs have not gone up, at least not much, and prices have doubled, tripled and even quadrupled. The question is not whether consumers are being gouged but whether anything should be done about it. The first priority in natural gas for our national energy policy should be to get to the bottom of why these gas prices have risen to the level they have, spiked the level they did last winter and remain at the level that they are today.

Through the efforts of a number of Congressmen, the General Accounting Office has agreed to undertake an investigation into this important issue. The subcommittee should urge the GAO to expedite this investigation so that its report may be issued in time for Congress to take any appropriate actions it needs to take in response to the GAO's findings before next winter. Congress should pass the Municipal Utility Natural Gas Supply Act of 2001 as an integral part of national energy policy to clarify existing law so that municipalities and their joint action agencies like Tennessee Energy Acquisition Corporation may utilize their tax exempt public financing capabilities to acquire long-term secure supplies to meet the needs of their members and the consumers they serve and thereby clear up confusion that has existed since August 25, 1999 caused by certain statements issued by the IRS and the Treasury Department in the preamble to a notice of proposed rulemaking on another topic.

Congress should recognize in a national energy policy that long-term security of the Nation as a whole and the natural gas industry in particular depends upon increased production of natural gas to meet growing demands and to replace depleting production to serve existing demands. Our Nation cannot be strong without a strong natural gas production profile and we need to utilize the resources we have and in an environmentally sound manner. At the same time Congress must recognize that natural gas cannot be the exclusive fuel used to meet the increasing demands of the generation of electricity. Our electric industry should utilize diversity of fuels. The environmental benefits of burning natural gas as the fuel of choice must be balanced against the environmental cost of

exploiting every available natural gas resource and economic cost of driving up prices for all natural gas consumers.

In addition, we need to take into account potential threat to the security of gas deliveries to consumers that will occur if we place a greater demand on our production and pipeline delivery capabilities than we have resources to meet.

Congress should also ensure that gas fired peaking and combined cycle electric generating facilities are not exclusively relying upon natural gas for fuel so that we do not create enormous new demand that are prices——

Mr. BARTON. Mr. McCutchen, could you summarize in 30 seconds, please, sir?

Mr. MCCUTCHEN. Yes, sir, yes, sir. People cannot afford the pay natural gas prices at current levels and our Nation's economy cannot sustain its strength with these types of prices: I ask you, as leaders responsive to the people you serve, what you will say to your constituents if natural gas prices go to \$8, \$10 and even higher next winter. Are we just going to tell them it is okay, folks, it is the market forces at work and you will be better off for it in the long run? I don't think so.

Thank you for your time.

[The prepared statement of J. Mark McCutchen follows:]

PREPARED STATEMENT OF J. MARK MCCUTCHEN, PRESIDENT AND GENERAL
MANAGER, TENNESSEE ENERGY ACQUISITION CORPORATION

Introduction

My name is J. Mark McCutchen. I am a native of Clarksville, Tennessee, and reside there with my wife and two children. Clarksville, the fifth largest city in the State of Tennessee, is in the 7th Congressional District, which is represented by Congressman Ed Bryant. I want to thank Chairman Barton, and Representative Bryant for inviting me to testify at this hearing and in so doing giving me the opportunity to provide information to this Subcommittee concerning the impacts of high natural gas prices on consumers and municipalities, to discuss some of the potential causes of the escalation in natural gas prices, and to comment on solutions that should be made part of the nation's energy policy.

Tennessee Energy Acquisition Corporation

I am the President and General Manager of the Tennessee Energy Acquisition Corporation, which is known as "Tennessee Energy" or "TEAC". Tennessee Energy is a public, not-for-profit, joint action organization formed by Tennessee municipalities which own and operate public natural gas distribution systems. The President and General Manager is the chief executive officer of the organization. Tennessee Energy's mission is to obtain the natural gas supplies that its member municipalities need to meet the gas requirements of the citizens, businesses, and industries in their communities and to ensure that those supplies are delivered to the members from distant production sources into their distribution systems for delivery to the consumers they serve, every day, without fail and without exception. We provide these services to our members, as their alter ego, on a not-for-profit basis. It is our mission to do so at the lowest possible cost consistent with the highest quality of service. We are directly accountable to our members, and ultimately to the natural gas consumers they serve.

Experience

My experience in the natural gas industry goes back to 1984, when I left the home-building industry and began a marketing position with the City of Clarksville Gas Department. I eventually became the Manager of the Department before assuming my present position as head of Tennessee Energy upon its formation. I hold a Bachelor of Science degree in Marketing from Austin Peay State University in Clarksville, Tennessee.

Responsibilities and participation in the gas markets

My responsibilities include buying and selling natural gas, on both a short-term and a long-term basis, to meet the needs of, and for the benefit of, Tennessee Energy's member systems. Tennessee Energy was formed by actions of the Cities of Clarksville and Springfield, Tennessee, in 1996, in response to the revolutionary changes in the natural gas industry that were brought about by Congress through passage of the Wellhead Decontrol Act of 1991, which deregulated the price at which natural gas was bought and sold at the wellhead, and by the Federal Energy Regulatory Commission through its Order No. 636, which was issued in 1992 and implemented in 1993. Order No. 636 required all of the natural gas distribution systems in the United States—whether they were publicly-owned like Clarksville and Springfield, or investor-owned like Nashville Gas Company—to begin buying their own natural gas supplies in the field, rather than at their citygates from interstate pipelines, contracting with the interstate pipelines for the transportation and storage of those supplies, and managing the fluctuations in load requirements. These were daunting responsibilities, but by 1996 Clarksville and Springfield were ready to take them on through their own organization, thereby eliminating the middleman. Doing so has saved the municipalities several million dollars since 1996.

Scope of participation in gas markets

Tennessee Energy now has 15 members from different parts of the State of Tennessee. They are the City of Clarksville, the City of Springfield, the West Tennessee Public Utility District, the Greater Dickson Gas Authority, the Town of Linden, the City of Waynesboro, the City of Savannah, the City of Lexington, the Town of Ridgely, the City of Bolivar, the City of Dunlap, the City of Pikeville, the Bedford County Utility District, the Town of Selmer, and the Town of Centerville. Together they serve 67 cities, towns, and communities throughout the State in 20 counties. In total, Tennessee Energy provides service of 125,000 MMBtu per day during peak winter periods, and 15,500,000 MMBtu annually. We manage transportation and storage contracts for the delivery of gas supplies on three interstate pipelines—Tennessee Gas Pipeline Company, ANR Pipeline Company, and East Tennessee Natural Gas Company. Together our members serve approximately 75,000 residential, commercial, industrial, governmental and institutional customers. That number of customers equates to approximately 200,000 people who receive gas service through our organization.

Daily activity in gas markets

In my responsibilities as the chief executive officer of Tennessee Energy, I follow the natural gas marketplace constantly. We do long-term contracting with suppliers. We have structured long-term prepaid gas supply contracts and utilized our public financing capabilities to acquire super-secure gas supplies at economical prices. We supplement our members' needs with short-term purchases in the market. We also balance our members' requirements by selling gas from time to time in the spot market. I follow natural gas prices in the markets constantly to assist our members in managing price risks by hedging against the volatility of gas prices and to attempt to reduce overall costs to the members, and ultimately to the gas consumers they serve.

What happened to gas prices?

Beginning a little over a year ago, natural gas prices in the market began to explode. As I have said, I have been active in the natural gas markets for a long time, basically since the beginning of the deregulated market. Nothing even remotely like what has occurred over the past year ever occurred before. Here is the context. For the entire decade of the 1990s, from the beginning of the trading of the natural gas futures contract on the New York Mercantile Exchange (NYMEX), the average price was about \$2.00 per MMBtu.¹ There were increases and decreases over time, as one would expect in a volatile market like the natural gas market, and there was a small gradual increase over time as one would expect with a finite resource, but overall the price did not increase very much. But this past winter, the commodity price of gas in the marketplace skyrocketed to \$9.82 per MMBtu for the month of

¹ MMBtus are units of heating value. Btus are "British Thermal Units". "M" stands for 1,000. So one MMBtu equals 1,000,000 British Thermal Units. One MMBtu is ordinarily contained in approximately one Mcf (thousand cubic feet) of natural gas. Gas is bought and sold either in MMBtu or Mcf measurements. In retail bills, gas is often sold in smaller units—either in 100 cubic feet units or in therms or dekatherms. One dekatherm equals one MMBtu, and one therm is $\frac{1}{10}$ of a dekatherm. The 10-year average for the decade of the 1990s of monthly Index prices delivered into Tennessee Gas Pipeline Company's Zone 1, where Tennessee Energy takes delivery of most of its supplies, was \$1.947 per MMBtu.

January, more than four times the traditional price. In January 2000, it was \$2.30 per MMBtu.

The increase in gas prices was sudden

Most of Tennessee Energy's member municipalities are connected to the interstate pipeline system of Tennessee Gas Pipeline Company, which is now owned by El Paso Corporation, one of the nation's largest energy companies.² The market price for natural gas in communities connected to the Tennessee Gas Pipeline company system is largely set by reference to the market price at which gas is delivered into that pipeline system in the producing regions of the Gulf Coast. As I mentioned, for January 2000, the market price (referred to as the "Index" price) was \$2.30 per MMBtu. By May 2000, the Index price had climbed to \$3.03 per MMBtu, the first time natural gas Index prices delivered into Tennessee Gas Pipeline had exceeded \$3.00 per MMBtu for any month since November 1997. In fact, there were only five months ever prior to May 2000 when the Index price delivered into Tennessee Gas Pipeline had exceeded \$3.00 per MMBtu since the beginning of the publication of Index prices. I have included an exhibit to my testimony which shows the monthly Index prices delivered into Tennessee Gas Pipeline beginning with January 1988 and continuing through May 2001. The highest price ever had been \$3.84 per MMBtu, which occurred for the month of January 1997 during a time of bitter cold and peak demand. By June of 2000 (a month of warm weather and low demand), the Index price had skyrocketed to \$4.32 per MMBtu, breaking the previous record by almost 50 cents per MMBtu. That price was exceeded again in September 2000, when the Index price rose to \$4.52 per MMBtu, and that record price was exceeded again only a month later in October 2000, when the Index price soared to \$5.19 per MMBtu. After a decline to \$4.42 per MMBtu for November 2000, prices then exploded again, reaching \$5.92 per MMBtu for December 2000, \$9.82 per MMBtu for January 2001, and \$6.13 per MMBtu for February 2001. The price for May 2001 was \$4.79 per MMBtu, which, though obviously significantly less than last winter's prices, is still higher than the price for any month ever until October 2000, and twice as high as traditional prices.

What have these prices done to Tennessee Energy's member municipalities and the consumers they serve?

It is difficult to convey in words just how devastating these price increases have been. The raw numbers do not begin to tell the story. Tennessee Energy and its member municipalities all operate on a not-for-profit basis. We are public gas, operated for the benefit of the public. Tennessee Energy's costs to acquire the gas supply that we sell to our members is tied to market prices, as is the case now throughout the natural gas industry since the advent of deregulation and the implementation of FERC Order No. 636. We hedge against the risks of price volatility on behalf of our members, at their request, and as a result will lock in or fix the price of a certain portion of their needs over future periods. But neither we, nor any of our members, consider it to be prudent to lock in the price of all of our gas supplies because so many customers want or need to have their pricing be responsive to market prices. In any event, the period of time when a distribution system is most interested in having prices fixed is for the winter months, to protect against price spikes during those months, and the time to lock in those prices is during the spring, summer and fall leading up to the winter. Last year, prices escalated to unprecedented levels by spring and then went higher, allowing no opportunity for hedging. What were people supposed to do, lock in prices when they were at all time highs? For Tennessee Energy's supplies that its members have not hedged, the market price defines our actual costs of acquiring gas for the members. And so the members' actual costs are in turn defined by the market price. The members sell delivered gas supply to their customers. The gas supply component of the delivered cost, which is a substantial portion of the total, doubled, tripled, or quadrupled depending upon the month. And, of course, the highest prices were during the months of greatest consumption. Every one of our members was required to increase its rates to its customers substantially, in several cases more than once. This meant, of course, that gas consumers had to pay *substantially* more for the fuel they needed to heat their homes or businesses, or for industrial purposes. No one escaped. Many consumers could not afford to pay their bills. This included some of the best customers, people

²Tennessee Gas Pipeline Company was once the flagship company of Tenneco Inc. But acquisitions, mergers, and takeovers in the industry have resulted in fewer and fewer energy companies. When El Paso acquired Tenneco, it boasted that its interstate natural gas pipeline network extended "from Bakersfield to Boston". El Paso is a major player in California, in New England, in Tennessee, and in states and regions across this land.

who always pay on time. Our member municipalities knew that their citizens and customers could not afford to absorb the entirety of the increase as soon as it occurred. They waited, hoping prices would come back to traditional, or at least acceptable, levels. They dipped into reserves before increasing rates. The City of Springfield, for example, deferred indefinitely a planned program of system improvements for which it had been accumulating reserves in order to protect its customers from having to absorb the entirety of the increase in gas costs. Tennessee Energy itself depleted its reserves because of the impact of escalating prices. Other municipalities or districts borrowed against lines of credit. They established deferred payment plans. But public gas systems ultimately cannot sell gas at a loss or give gas away for free, and if people could not pay their bills they had to be disconnected.

What did the increase in gas costs mean for the average residential consumer?

Typical residential consumers in Tennessee served by our members saw gas bills go from \$100 per month to \$250 per month, or from \$200 per month to \$500 per month. This happened to everybody. People were not spared these increases in fuel costs because they were living on fixed incomes, or living on budgets, or otherwise could not afford them. People were forced to choose between paying their heating bill or paying for other necessities of life, including medicines and food, mortgage payments and rent, car and truck payments, and college tuition for their children. There is a federal program (LIHEAP) to provide home heating bill assistance for people living below the poverty line. But these cost increases put a major hurt on millions of middle class people who are living well above the poverty line. This happened not only in Tennessee, but across the Southeast and across the nation.

Where did the money go?

Across the nation, millions upon millions of dollars left the pockets of millions of hardworking people and the bank accounts of thousands of businesses and industries and went into the coffers of a handful of energy companies. The increase in gas costs from the three winter months of 1999-2000 to the three winter months of 2000-2001 for our eight members that we served both years totaled \$32,000,000 more this year than last. Those \$32,000,000 left Tennessee and went to bonuses, commissions, and shareholder profits for a handful of companies. Some of those companies are natural gas producers. Some of them are the major gas and electricity marketing and trading companies that have been formed in the wake of deregulation. These computerized marketing and trading companies operate outside of virtually any regulatory oversight and have taken control of the market place, as far as I can see.

Have the costs of production of natural gas increased?

No. The marginal cost of production, according to industry experts that I have talked with, varies by region across North America, but is well below \$2.00 per MMBtu everywhere. The lowest marginal costs are reportedly in Canada. It has been said over and over again that the natural gas production industry would flourish if prices stabilized over the long run at about \$2.75 per MMBtu. Indeed, the energy sector of our economy thrived in 1999 when prices were well below that level.

Have gas consumers been gouged?

Unquestionably. I trust that is not the subject of dispute. Costs have not gone up, certainly not appreciably, and prices have doubled, tripled or quadrupled. If that isn't gouging, I don't know what is. The question is not whether consumers are being gouged, but whether anything should be done about it. And there is disagreement on that. Congress determined a decade ago that natural gas prices should be fully deregulated at the wellhead, completing a process that began with the passage of the Natural Gas Policy Act in 1978. Congress determined that there was a sufficiently competitive market at the wellhead to prevent the exercise of market power in pricing by producers. Of course, when Congress reached that conclusion, there was no such thing as national gas and power marketers, there was no NYMEX, there was no after-hours Access Trading, there was no day trading, there was no on-line computerized trading, there was no Internet. There was no explosion in the desire to use natural gas for the generation of electricity, there was no deregulation of electricity markets, and there was no subtle interplay of Wall Street analysis, mainstream media reporting, gas industry trade press, and unregulated market trading that could be "spun", and thereby "spin" market perceptions, in one direction or another. I am aware that there are many economists who simply believe that market forces are working in the gas industry and that they should be allowed to work, and that if prices for natural gas are too high for people to afford heating their homes, people should simply be cold and put on sweaters. I know some of them, and I have heard them say it. All I can say is that I hope we never sink to

the point where our national energy policy is set by economists. Our nation can't afford it. They like to say that the cure for high prices is high prices—that is, high prices will lead to increased production of gas, which will in turn lead to a surplus of gas, which will in turn lead to lower prices. But I am not buying. Natural gas is a necessity for people, not a luxury like buying a new Lexus or a skiing trip to Europe. Natural gas is not subject to the textbook laws of supply and demand, because demand for the commodity is price inelastic. Of course there is a certain amount of demand that can be influenced at the margin by higher or lower prices. But it is only a small fraction of the total demand. People will not turn off their heat because gas prices are too high and go cold all winter across a whole city, and make their children go to school in frigid buildings, and expect their ailing parents to lie in a hospital bed with the thermostat set at 60°. No one should ask people to do those things, and it is *our* job—those of us who are in the industry and positions of public responsibility—to make sure that people don't have to make that choice. It is my job, and it is your job. People cannot afford to pay natural gas prices at current levels, and our nation's economy cannot sustain itself with those types of prices. And people cannot afford another winter of price spikes like we experienced last winter. The industry itself cannot afford for that to happen. We will lose all credibility. And I ask you, as leaders, what you will say to your constituents, if prices go to \$8.00 per MMBtu, \$10.00 per MMBtu, or higher again next winter. Are you going to tell them: "It's okay, folks, it's market forces at work, and you'll be better off for it in the long run." I don't think so.

Should our national energy policy include reregulation of natural gas prices?

I am not advocating reregulation. But I am saying that something must be done about excessive natural gas prices. The first step has got to be for Congress to determine for itself what has caused the run-up in gas prices that we have experienced since the end of the winter of 2000. I cannot accept, based upon what I have seen and what I see now, that we are simply witnessing the results of the laws of supply and demand at work. There is no gas shortage. There is none now, and there was none this past winter. Sure it was obvious to those of us in the industry that supplies were tighter this past winter than they were during the previous winter. But tighter does not mean a supply-demand imbalance. There was no shortage. There is no customer anywhere in the United States that I have talked to who wanted to buy gas and was willing to pay the market price for it who was not able to find gas to buy. People were even able to buy gas in excess of firm entitlements. There were no curtailments such as the industry experienced in the 1970s. That was true even on the coldest days, and we experienced the coldest winter in many years. The "conventional wisdom"—actually nothing more than "spin" from those who stood to gain by the acceptance of the "spin" as far as I'm concerned—was that we had a "supply and demand imbalance"—that is, demand exceeded supply. That was demonstrably not true. As I said, everyone who wanted to buy gas could find it. The only "curtailments" that occurred were not supply shortages, but were shortages of necessary delivery capacity to get gas to certain locations.

Wasn't there a shortage of gas in storage?

No. That was another of the examples of "spin" that you kept hearing about all last year. Natural gas storage fields are not like fuel oil tanks. We would read, for example, that "inventories" of natural gas were low, suggesting that our cities would run short of supplies when the weather got cold, like the specter of a tank farm with depleted fuel oil supplies. There is no such analogy between the industries. Distribution systems, like Tennessee Energy's member municipalities and hundreds of investor-owned and publicly-owned gas systems across the land, have retained storage capacity entitlements on their interstate pipeline systems since the implementation of FERC Order No. 636. Before Order No. 636, the pipelines controlled all of the storage as part of their merchant service to their customers. The distribution systems, known as "LDCs" in the industry (short for local distribution companies), use their storage rights for two basic purposes—operational needs, and financial savings. A substantial portion of their storage capacity—I would say one-quarter is a good rule of thumb—is not necessary for operational requirements, but is only used to obtain economic benefits. Distribution systems, or their joint action organizations like Tennessee Energy, will put gas into storage for operational requirements no matter what the price is, and will fill that portion of storage regardless. But for the portion of storage capacity that is not needed for operational reasons but is only utilized to take advantage of price opportunities, people will not put gas into storage when prices are too high, or when there is not a sufficient "spread" between futures prices for a storage injection month and futures prices for a storage withdrawal month. That is what happened last year, and that is why the storage numbers

lagged below those of previous years. There was simply no economic reason to fill storage to traditional levels.

What about all the new demand for natural gas for electric generation?

There is no question that this is a long-term problem for the nation, and the natural gas industry, and that it must be addressed by Congress as part of its consideration of our national energy policy. The extraordinary number of natural gas-fired peaking facilities and combined cycle units that are proposed to be built across the United States will place a tremendous strain upon our available natural gas resources. But that specter of long-term demand for gas to fire electric generation facilities is in our future. It did not represent a significant increase in demand for gas during the summer of 2000.

If supply and demand do not explain the explosion in gas prices and the continuation of gas prices at excessive levels, what does?

I do not know, and that is what Congress must help this nation find out. I have a number of suggestions, which I will address in a moment, of areas where we should be looking and areas of oversight that the Congress should exercise. But first let me point out that the General Accounting Office, in response to specific requests from Congressman Bryant and a number of other Congressmen, including Representatives Clement, Tanner, and Wamp of my State of Tennessee, has announced that it will begin an independent investigation into the causes and impacts of high natural gas prices and potential solutions to the problem. The copies of the letters from Comptroller General David Walker to the requesting Congressmen that I have seen suggest that the GAO will not be undertaking the investigation in as timely a manner as I believe we need, because of a backlog of requests in other areas. I would stress to this Subcommittee the importance of urging the Comptroller General to expedite GAO's investigation into this area so that there will be time for the Congress to take whatever corrective actions, if any, are indicated by the results of the GAO study.

What are the areas that the GAO investigation should cover?

First, the GAO should determine the amount of gas supply that was available from domestic and Canadian production (as well as any imported LNG) and compare that to 1999 and previous years. Second, GAO should determine the level of demand experienced by class of natural gas consumers—residential, commercial, industrial, and electric generation, including both utility and non-regulated merchant generators. Next, GAO should determine the magnitude of natural gas-fired electric generation that came on line in the summer of 2000 as compared to levels during the previous years. Those are the basic elements of a supply and demand inquiry. Then there is the whole area of how natural gas prices are established in the deregulated marketplace, and issues associated with whether dominant market players were able to manipulate prices and set into motion forces that pushed us down the road to ruin last year. These areas include the following, though this is not meant to be an exhaustive list: The methods used to establish published spot market Index prices for natural gas; the role of the trading of futures contracts on NYMEX in the escalation of the market price for natural gas; the role of after-hours NYMEX Access Trading in the escalation of the market price for natural gas; the role of private on-line trading on “platforms” established by energy marketing and trading companies in the escalation of the price for natural gas; an examination generally of whether the manipulation of market prices occurred, and if so, how such manipulation can be prevented from recurring; and the role of the Commodities Futures Trading Commission (CFTC) in the regulation, or the lack of regulation, of trading in natural gas. The CFTC is the regulatory agency empowered by Congress to ensure that commodities markets, like NYMEX, are working as they should, and that participants are not able to exercise market power. The whole premise of deregulation was that market participants would not be able to exercise market power—that is, that the market would work. But something is obviously broken in the market and it must be fixed. As one of your colleagues in the House put it, “people should not have to choose between heating and eating.” Congress should ensure that the CFTC is doing its job—and if it turns out that the CFTC needs more tools to ensure that consumers are protected, then Congress should give it those tools.

Are there other areas that you believe should be the subject of inquiry?

Yes. The GAO investigation should also include an inquiry into the role of pipeline capacity constraints in the escalation of the price for natural gas. The FERC is the agency that Congress has entrusted with ensuring that the rates charged for the transportation and storage of natural gas are “just and reasonable”. The rule

of thumb is that “just and reasonable” means that rates cannot exceed costs plus a fair return, although where workable competition exists, lower rates may prevail. But in the real world, by the year 2000 the energy marketing and trading companies that now sell most of the gas that goes to LDCs and end users (such as industrial consumers and electric generation plants) also now control huge blocks of interstate pipeline delivery capacity, and sell a “rebundled” product on a deregulated basis, so that the gas commodity price and the transportation rate are not separated, and the transportation rate is effectively not capped by the regulated tariff rate. This has been an enormous problem in California, the magnitude of which I believe may only now be starting to sink in. We may well find that the nationwide escalation in gas prices last year, which continues to this day, can be traced back to the events of last summer in California and the fly-up in the price of natural gas delivered off the interstate pipeline systems at the California border that occurred.

What does the explosion in natural gas prices tell you Congress should do about natural gas as part of the national energy policy?

First, Congress needs to ensure that it understands the operation of the natural gas markets.

Second, it needs to ensure that the CFTC is doing its job, and that it has the tools it needs to do its job.

Third, Congress needs to ensure that FERC is doing its job.

Fourth, Congress needs to ensure that meaningful information is compiled and disseminated by the Department of Energy and its Energy Information Administration (EIA) on a timely basis. I will discuss this point a bit more in a few minutes.

Fifth, Congress should pass the Municipal Utility Gas Supply Act of 2001, to clarify existing law and ensure that municipalities and their joint action organizations like Tennessee Energy, are able to utilize their tax-exempt public financing capabilities to acquire long-term, secure gas supplies at economical prices to meet the needs of their members and the consumers they serve. It is tragic that in this period of excessive gas prices and electric generators buying up gas reserves that public gas systems have been unable to secure their future supplies by prepaying for gas through the issuance of tax-exempt bonds because of questions about the transactions raised by the Internal Revenue Service and the Treasury Department.

Sixth, Congress needs to ensure that our nation does not become overly dependent upon natural gas for the generation of electricity. We need a diversity of fuel sources for electric generation that are sustainable on a long-term basis. Congress should be reviewing clean coal technologies, oil burning technologies, nuclear, and renewables, in addition to natural gas. A continuation down the path we are on in which new electric generation is exclusively fired by natural gas not only will lead to excessive, and unnecessary, pressure on our finite natural gas resources, but also will create a whole new segment of the market whose demand is as price inelastic as is the demand of residential and small commercial load, and the size of which is comparable. Once capital costs are sunk in electric generation facilities that burn only natural gas (or are restricted to burning fuel oil only occasionally during a year), those units will be run whenever peak demand for electricity occurs, because they are the peaking units. It won't matter what the price of natural gas is. They will buy it and burn it. Thus, we face the specter of natural gas prices in the market being driven up by electric generation load precisely because the demand is price inelastic and the owners of the generating facilities can make money from selling the power even when gas prices are excessive. The gas market for traditional gas users—that is, everybody but electric generation facilities—will become whipsawed by the electric generators. And the very companies that are the predominant sellers of gas in the marketplace (that is, the giant energy marketing and trading companies) are the very companies which own the gas-fired generating facilities and market their output. Thus, we face the threat of competing for gas with the very companies that are the predominant sellers of gas in the market. This is a situation that is ripe for disaster for the natural gas industry, natural gas consumers, and the nation's economy as a whole.

Seventh, Congress needs to guard against the electric generating companies buying up our gas reserves and pipeline capacity to fuel power plant needs. We are starting to see this happen. The electricity industry is much larger than the gas industry; but the gas industry's health is of equal national importance. Over 50 million households—over half of all households—heat with natural gas. Natural gas cannot be relegated to simply being the fuel to make electricity.

Eighth, and I could say “first”, we need to establish policies that will enable us to produce more natural gas. The nation simply must produce the gas it needs from the resources we have, and must establish policies that enable us to do so on an environmentally sound basis.

You said you wanted to comment further about timely information.

Yes. One of the biggest problems I see in the gas market today is that there is so little useful information available about market fundamentals. And as a result, market perceptions have come to dominate market transactions to such an extent that they have become market reality. Everyone talks about fundamentals as driving this market. But I don't think fundamentals have had anything to do with it. And even if they did last year, fundamentals right now would have resulted in gas being back to \$2.50 per MMBtu or less. Gas is at \$4.30 per MMBtu. Because so little information is available, and because what is available tends to be incomplete or outdated, we have seen the market respond to "hard data" that really don't mean what they are taken to mean, such as the storage numbers that I discussed earlier. The market waits with baited breath for the weekly storage injection or storage withdrawal figures to be released by the American Gas Association, as though these numbers really meant something about market fundamentals. Part of the problem is that they are all that anyone has. Production data lags by several months. An example of the problems associated with that lag is that we went through the entire year of 2000 hearing that domestic U.S. production was down (supposedly supporting the view that there was a supply shortage), and putting aside the fact that imports from Canada were up by far more than enough to offset the projected decline in U.S. production, when in fact we learned in April that U.S. production in 2000 was actually up. So what we have ended up with is a situation in which those who want to "spin" public perception have an easy time of doing so. I believe Congress should make sure that the EIA is doing its job to the maximum extent possible, and that it does a better job of disseminating the information that is available. For example, at a recent press conference in which EIA officials were explaining their energy outlook for the summer to the national press corps covering energy issues, the spokesman for EIA, in discussing natural gas pricing, "explained" that part of the reason for EIA's continued projections for high natural gas prices was that storage numbers remained low, and according to this official, speaking for EIA, the importance of the storage number was that producers put gas into storage in the summer in order to sell it in the winter. This is so uninformed that it would be funny if it weren't so serious. This same spokesman, the official voice of the federal government, told the press corps that he thought the Henry Hub (the location of the point of delivery for the NYMEX future contracts that is at the tailgate of a Texaco processing plant in Louisiana where there are some 15 pipeline interconnections) was in Oklahoma. We need better information being disseminated and we deserve it.

Conclusion.

As you can tell, the issue of natural gas prices is one that I live and breathe, and which is close to my heart. I appreciate very much having this opportunity to give you my comments and recommendations. I am available to discuss these issues further on a more detailed basis with you and members of your staff at any time, and would welcome the opportunity to do so as you continue your work in this area. I am available to answer any questions you may have now.

Tennessee Gas Pipeline Zone 1 monthly index prices

as reported by Inside FERC's Gas Market Report

DATE	INDEX (\$ per MMBtu)
Jan-88	2.10
Feb-88	2.00
Mar-88	1.80
Apr-88	1.40
May-88	1.35
Jun-88	1.34
Jul-88	1.44
Aug-88	1.55
Sep-88	1.70
Oct-88	1.68
Nov-88	1.91
Dec-88	2.20
Jan-89	2.15
Feb-89	1.75
Mar-89	1.43

Tennessee Gas Pipeline Zone 1 monthly index prices—Continued
as reported by Inside FERC's Gas Market Report

DATE	INDEX (\$ per MMBtu)
Apr-89	1.56
May-89	1.68
Jun-89	1.67
Jul-89	1.62
Aug-89	1.53
Sep-89	1.49
Oct-89	1.55
Nov-89	1.77
Dec-89	2.10
Jan-90	2.40
Feb-90	2.00
Mar-90	1.50
Apr-90	1.48
May-90	1.46
Jun-90	1.48
Jul-90	1.42
Aug-90	1.34
Sep-90	1.35
Oct-90	1.55
Nov-90	2.05
Dec-90	2.25
Jan-91	1.85
Feb-91	1.34
Mar-91	1.32
Apr-91	1.33
May-91	1.30
Jun-91	1.25
Jul-91	1.10
Aug-91	1.13
Sep-91	1.38
Oct-91	1.72
Nov-91	1.73
Dec-91	1.90
Jan-92	1.65
Feb-92	1.02
Mar-92	1.19
Apr-92	1.35
May-92	1.53
Jun-92	1.65
Jul-92	1.45
Aug-92	1.85
Sep-92	1.91
Oct-92	2.61
Nov-92	2.30
Dec-92	2.18
Jan-93	1.88
Feb-93	1.59
Mar-93	1.84
Apr-93	2.14
May-93	2.60
Jun-93	1.86
Jul-93	1.81
Aug-93	1.95
Sep-93	2.27
Oct-93	1.92
Nov-93	2.05
Dec-93	2.33
Jan-94	1.98
Feb-94	2.31
Mar-94	2.32
Apr-94	1.92

Tennessee Gas Pipeline Zone 1 monthly index prices—Continued
as reported by Inside FERC's Gas Market Report

DATE	INDEX (\$ per MMBtu)
May-94	2.00
Jun-94	1.73
Jul-94	1.87
Aug-94	1.70
Sep-94	1.40
Oct-94	1.35
Nov-94	1.62
Dec-94	1.64
Jan-95	1.57
Feb-95	1.37
Mar-95	1.42
Apr-95	1.50
May-95	1.60
Jun-95	1.64
Jul-95	1.42
Aug-95	1.30
Sep-95	1.50
Oct-95	1.58
Nov-95	1.73
Dec-95	2.24
Jan-96	3.25
Feb-96	2.33
Mar-96	2.81
Apr-96	2.58
May-96	2.10
Jun-96	2.28
Jul-96	2.57
Aug-96	2.22
Sep-96	1.72
Oct-96	1.75
Nov-96	2.63
Dec-96	3.73
Jan-97	3.84
Feb-97	2.79
Mar-97	1.66
Apr-97	1.76
May-97	2.04
Jun-97	2.24
Jul-97	2.07
Aug-97	2.11
Sep-97	2.46
Oct-97	3.02
Nov-97	3.20
Dec-97	2.45
Jan-98	2.19
Feb-98	1.93
Mar-98	2.19
Apr-98	2.24
May-98	2.21
Jun-98	1.96
Jul-98	2.29
Aug-98	1.85
Sep-98	1.53
Oct-98	1.95
Nov-98	1.93
Dec-98	2.05
Jan-99	1.71
Feb-99	1.75
Mar-99	1.57
Apr-99	1.84
May-99	2.30

Tennessee Gas Pipeline Zone 1 monthly index prices—Continued
as reported by Inside FERC's Gas Market Report

DATE	INDEX (\$ per MMBtu)
Jun-99	2.16
Jul-99	2.21
Aug-99	2.54
Sep-99	2.83
Oct-99	2.47
Nov-99	2.97
Dec-99	2.07
Jan-00	2.30
Feb-00	2.58
Mar-00	2.56
Apr-00	2.83
May-00	3.03
Jun-00	4.32
Jul-00	4.29
Aug-00	3.74
Sep-00	4.52
Oct-00	5.19
Nov-00	4.42
Dec-00	5.92
Jan-01	9.82
Feb-01	6.13
Mar-01	4.91
Apr-01	5.28
May-01	4.79

Mr. BARTON. Thank you, Mr. McCutchen. We will work with you and Congressman Bryant on this issue obviously. We now want to hear from Mr. Mahlon Anderson, who is Director of Public Affairs for the American Automobile Association. Your statement is in the record and we would ask that you summarize in 5 to 7 minutes. You might pull that microphone up close to you. They are very directional.

STATEMENT OF MAHLON G. ANDERSON

Mr. ANDERSON. Okay. Good afternoon, Mr. Chairman, members of the committee. I am Lon Anderson, Director of Public Affairs for AAA Mid-Atlantic, the third largest AAA club in the United States with nearly 3.3 million members and part of the 44 million AAA member family.

We all know that gas prices right now are outrageous, especially given the low unstable price of crude oil on the world market. Motorists by the millions are suffering a relatively new phenomenon known as massive sticker shock every time they pull in to fill up. Prices shot up over 20 cents per gallon just in the last month of April. It is unprecedented.

Currently our national average is \$1.72. That is this morning, my apologies to Mr. Cook, but \$1.72 per gallon and in the Midwest and on the West Coast prices are regularly exceeding \$2 per gallon for self-serve regular. If prices are sustained at that level for long periods, the impact could be very serious and widespread. At \$1.72 per gallon, were to it be sustained for a year, typical families with two cars will have to spend at least an additional \$560 just to drive the same distances that they drove the previous year.

Putting these prices in an historical perspective, for the decade of the nineties the national average for a gallon of self-serve regular was \$1.17. More recently just for the last 3 years, 1998, 1999, 2000, the national average for gas for self-serve regular was \$1.26. So today's prices are 45 cents a gallon higher than that of the last 3 years, an increase of 36 percent, where compared to that in the nineties is a whopping 46 percent higher.

Clearly the impact depends on how long these prices stay stuck in the stratosphere. But looking toward summer tourism, it is important to remember that driving is the means that more than eight in 10 families use to go on summer vacation. That said, I think it is also clear that having to pay an extra \$15 or \$20 or \$25 for gasoline for a summer vacation trip is probably not enough to deter the average family from taking that trip, but when you couple that with the record high winter heating bills, and many families are still paying them off, these high gas prices could be the proverbial straw that breaks the back of a family's vacation budget.

Last, we all know that over the long term high fuel prices will literally fuel high costs of virtually everything from food to clothes to services and thus fuel inflation, and let me briefly discuss what we at AAA Mid-Atlantic should be doing about these prices.

As you know, our current record breaking prices are not OPEC's fault. Last summer crude oil prices, largely because of OPEC's actions, were record highs of \$38 a barrel causing those problems. However, since this year, since the beginning of the year, our crude oil price has been relatively stable, running \$25 to \$30 a barrel.

Those prices are not what is causing today's record prices at the pumps. No. These prices appear to be largely self-inflicted, stemming from a lack of investment in refining and distribution capacity, industry consolidation and a patchwork of fuel requirements that creates major refining and distribution challenges.

For more than 25 years AAA has tracked gas prices and motorists' reactions to them, and that is why we believe that a key to stable gasoline prices and supply is to identify the needs and expectations of America's motorists who are the end users of gasoline.

First, a clean environment. A clean environment is absolutely crucial to our 44 million AAA members nationwide, and they don't want to see the gains that we have made over the last few years lost. But they also want affordable gasoline. That said, we also know that motorists will consider purchasing more energy efficient vehicles as well as lower emission alternative fuel vehicles if a successful case can be made in the marketplace for these products. Federal policies promoting, but not mandating, such vehicles would be helpful.

Second, given the financial challenges that drivers already face at the pumps, they would probably accept some of the cost of switching to a single clear burning fuel nationwide, if that would lead to more stable prices. Motorists in almost all of our major cities are required to use more expensive, cleaner burning summer grade and winter grade fuels for their vehicles. The problem is that these regulations now require a patchwork of approximately 14 different blends of cleaner burning fuels that vary from city to city, State to State, season to season. We should begin to move forward now to implement a single gasoline standard that benefits the envi-

ronment, motorists and the fuel industry. In the meantime, we also urge that fuel additive requirements be suspended, but only on an emergency, case by case, as needed basis for local areas as was done in the Midwest last summer.

Third, motorists want and must have adequate and secure energy supplies. Given current record prices due to our own refining and supply issues, it is clear that we must pay more attention to maintaining and expanding our domestic refining and gasoline distribution infrastructure. It is perhaps noteworthy that it was a quarter of a century ago, 1976, when America's newest and our last refinery went on line and that was in Garyville, Louisiana.

Last—

Mr. BARTON. And this will have to be last.

Mr. ANDERSON. It is, sir. I promise.

We must be able to assure motorists that no one is taking unfair advantage of them. The petroleum industry is incredibly complex and the opportunities to manipulate prices certainly exist. Further, oil companies' recent record breaking profits certainly add to the perception among motorists that maybe they are being taken advantage of. Therefore, we believe stronger Federal and State oversight is necessary to ensure fair competition among station owners, distributors, refiners, drilling firms and energy traders.

AAA believes America's motorists must be kept top of mind as the United States moves to enact new energy policies. We think that by doing so you and the Congress and the White House will be able to be more confident that we can achieve the Nation's energy and environmental goals and that drivers won't have to suffer sticker shock each time they fill up.

Again, thank you to so much for the privilege of testifying.

[The prepared statement of Malon G. Anderson follows:]

PREPARED STATEMENT OF MAHLON G. "LON" ANDERSON, DIRECTOR OF PUBLIC AFFAIRS, AAA MID-ATLANTIC

Good afternoon, Mr. Chairman, Members of the Committee. I'm Lon Anderson, Director of Public Affairs for AAA Mid-Atlantic, the third largest AAA Club in the United States with nearly 3.3 million members, covering a territory including Southeastern Pennsylvania, some of New Jersey, all of Delaware, Maryland, DC and most of Virginia. Thank you for seeking our testimony.

We all know that current gas prices are outrageous, given the relatively low and stable price of crude oil on the world market. Motorists by the millions are suffering massive sticker shock every time they pull in to their local service stations to fill up. Prices shot up over 20 cents per gallon for self-serve regular just in the month of April. It's unprecedented.

Currently our national average is \$1.71 per gallon. As you all well know, in the Midwest and on the West Coast prices exceeding \$2 per gallon are not unusual. If prices are sustained at this level for long periods, the impact could be serious and widespread.

At \$1.71 per gallon, were it to be sustained for a year, typical families with their two cars will have to spend an additional \$560 just to drive the same distance they traveled last year. Putting this in an historical perspective, for the decade of the 90's the national average for a gallon of self-serve regular is \$1.17. More recently, for the last three years—1998, '99, and 2000—the national average for a gallon of self-serve regular was \$1.26. So today's prices are 45 cents per gallon higher than that of the last three years—an increase of 36%—or, compared to that of the '90's, a whopping 46% higher.

What's the impact likely to be? Clearly that depends on how long these prices stay in the stratosphere. But looking towards summer tourism, it is important to remember that driving is the means more than 8 in 10 American families choose for vacation travel. That said, I think it's also clear that having to pay an extra \$15 or \$20 on gas for a driving vacation is not, alone, enough to stop most families from taking

their vacation. However, when this is coupled with the record-high winter heating fuel bills some may still be paying off, and the downturn in employment, high gas prices could be the proverbial straw that breaks the back of the family's vacation budget.

Lastly, we all know that over the long term, high fuel prices will—literally—fuel higher costs for virtually everything else—from food to clothes to services—and thus fuel inflation.

Now let me turn briefly to discuss what we at AAA Mid-Atlantic believe we should be doing about these prices.

As you know, this year there is a big difference from last summer's skyrocketing prices. Our current record-breaking prices are not OPEC's fault. Last summer, crude oil prices, largely because of OPEC's actions, were at record highs—as much as \$38 per barrel—causing our then-record high prices at the gas pumps. This year, crude oil supplies are adequate and their prices have been relatively stable, running between \$25 and \$30 per barrel. Clearly, crude oil prices are not driving today's highest-ever-recorded gas prices locally or nationally.

This year, the price hikes appear to be largely self-inflicted, stemming from lack of investment in refining and distribution capacity, industry consolidation and many years of policy decisions focused on curtailing auto emissions and improving air quality.

For more than 25 years, AAA has tracked gas prices—and motorists—reactions to them. That is why we believe a key to stable gasoline prices and supplies is to identify the needs and expectations that are most important to the end users of gasoline—the motorists.

First, a clean environment is crucial to our members within our five-state territory, as well as to our 44 million AAA members nationwide—and they don't want to give back the gains we've made in air quality. But they also want affordable gasoline. In short, motorists want both clean air and reasonable gasoline prices. That said, we also know that motorists will consider purchasing more energy efficient vehicles, as well as lower emission or alternative fuel vehicles, if a successful case can be made in the marketplace for these cars and trucks. To be competitive, and therefore appealing to motorists, these vehicles must be safe, have a reasonable purchase price, be cost-effective to fuel and service, and they must have a fair resale value after several years of use. Federal policies promoting—but not mandating—such vehicles would be helpful.

Second, while motorists would like a return to much lower prices, they will probably be satisfied with more stable gasoline prices—even if they are somewhat higher than those they have been used to. But families—not to mention businesses and governments—need to be able to accurately budget for their gas bills that will increase nearly \$600 on average this year for the typical two-vehicle household. Consumers want to be able to forecast the expense of fueling a new car they might wish to purchase, or to know in general terms how much the summer vacation drive is going to cost.

Given the financial challenges drivers already face at the pumps, they would probably accept some of the cost of switching to a single cleaner-burning fuel nationwide, if it would lead to stable prices. Motorists in almost all of our major cities are already required to use more expensive, cleaner-burning summer grade fuels in their vehicles. The problem is our current patchwork of regulations requires 14 different blends of cleaner burning fuels that vary from city-to-city, from state-to-state and season-to-season. This patchwork is at times arbitrarily drawn and can lead to market instability. We should begin moving forward now to implement a single gasoline standard that benefits the environment, motorists and the fuel industry. To do this will require setting a realistic nationwide implementation period, removing legal and administrative roadblocks to building needed transportation infrastructure, and maintaining reasonable price stability through tax incentives or other inducements to gasoline refiners and distributors.

In the meantime, we would also urge that fuel additive requirements be suspended on an emergency, case-by-case, as-needed basis for local areas, as was done for some Mid-West areas last summer when prices exceeded \$2.50 per gallon because of spot shortages of particular additives.

Third, motorists want—and must have—adequate and secure energy supplies. Few national security issues are better understood by Americans than the need for adequate domestic oil production, strong trading alliances with reliable oil-producing countries and the need to keep sea lanes open so oil can be freely shipped. However, given our current record prices due to our own refining and supply issues, it is clear that we must pay more attention to maintaining and expanding our domestic refining and gasoline distribution infrastructure. It is perhaps noteworthy that it was a quarter of century ago—1976—that our last refinery went on line in

Garyville, LA. We must be able to meet our increasing demand to ensure that adequate inventories of gasoline are available to motorists at all times, and, most especially, to be able to meet demands in times of national emergencies.

Lastly, we must be able to assure motorists that no one is taking unfair advantage of them at the pumps. The petroleum industry is incredibly complex and opportunities to manipulate prices do exist. Further, oil companies recent record-breaking quarterly profit reports certainly create the perception among motorists that maybe they are being taken advantage of. Therefore, we believe stronger federal and state oversight is necessary to ensure fair competition among station owners, distributors, refiners, drilling firms and energy traders.

With nearly 3.3 million members in our AAA Mid-Atlantic territory and over 44 million nationwide, AAA believes America's motorists must be kept top-of-mind as the United States moves to enact new energy policies. By doing so, the White House and the Congress can be more confident that we can achieve the nation's energy and environmental goals, and that drivers won't suffer sticker shock with each new fill-up at the gas pumps. Thank you again for the privilege of allowing me to testify before you.

Mr. BARTON. Thank you. And again, I paid \$1.73 in Arlington, Virginia, this morning, but yesterday or day before in Ennis, Texas, I paid \$1.52.

Mr. ANDERSON. Was that in Texas?

Mr. BARTON. Yes, sir.

Mr. ANDERSON. Oh, Okay. I would say you can go just a few miles outside of Washington, DC, you go outside that area and down 95 and you will hit 20 cents less a gallon because they are outside of the nonattainment area so they can buy straight gasoline.

Mr. BARTON. In Waco, Texas, when I went to see my mother the week before last, I paid \$1.41. But the prices are too high and I certainly support and the committee supports the thrust of your testimony.

Mr. ANDERSON. Thank you, sir.

Mr. BARTON. We want to hear from Mr. Glen Buckley now, who is the Chief Economist and Director of Agribusiness for CF Industries, and it is located, at least their national office, in Washington DC. Your testimony is in the record. We ask that you summarize in 5 to 7 minutes, sir.

STATEMENT OF GLEN N. BUCKLEY

Mr. BUCKLEY. Thank you, Mr. Chairman. I am here today representing CF Industries. CF is the farmer-owned cooperative and one of the largest fertilizer manufacturers in North America. We also operate one of the largest nitrogen complexes in the world, which happens to be in Chairman Tauzin's district.

CF, through its member owners, accounts for approximately 25 percent of the nitrogen fertilizers used by American farmers, and one-third of the nitrogen fertilizers used in the Midwest.

Today the focus of my statement will be on natural gas and the impact that it has had on the North American nitrogen industry. Natural gas is the only feedstock used in the production of nitrogen fertilizers and accounts for 75 to 90 percent of the total cash cost of production. As a result, the sharp rise in natural gas prices that has occurred over the last year has had a devastating impact on our industry.

Last fall the run-up in natural gas prices forced production costs to the point where producers were facing significant financial losses. Not surprisingly, virtually every producer in the industry

was forced to either idle plants and/or significantly curtail production. As a result, the industry operating rate fell to 57 percent in December and to a record low of 47 percent in January.

To put this into perspective, the average annual U.S. operating rate during all of the 1990's was 92 percent. The moderation in natural gas prices over the last few months has allowed the industry operating rate to move back into the 75 to 78 percent range. Unfortunately, this appears to be only temporary.

Under today's natural gas prices most of the industry is at best operating at a cash break-even position with many plants running for the sole reason of meeting supply commitments for the spring season. Based on recent estimates, the U.S. operating rate is likely to drop back into the 50 to 60 percent range this month and possibly below 50 percent in June. Again, this compares to an operating rate over the last 10 years that seldom fell below 90 percent of capacity.

In Louisiana, the largest nitrogen producing State, seven of the 12 plants are currently idled with two additional plants expected to be idled within the next month. The sharp escalation in natural gas prices and the resulting curtailment of the U.S. production facilities has also had a devastating impact on the American farmer. Ammonia prices at the farm level, for example, have almost doubled, escalating from an average over the last 2 years of approximately \$218 per ton, to an average this spring of almost \$400. Absent a substantial long-term reduction in natural gas prices, the U.S. domestic nitrogen fertilizer industry is at serious risk.

Of the 19 million tons of capacity in the U.S., approximately 1 million tons has already been permanently closed and, according to a recent industry analysis, another 5 million tons could possibly close within the next 1 to 2 years. In addition, it is anticipated that the remainder of the industry will likely operate on a swing basis; that is, plants will only run when natural gas prices are low enough and/or fertilizer prices are high enough that producers can at a minimum cover their cash cost of production.

This spring, imports offset part of the loss in U.S. production. Increasing reliance on imports, however, is not the answer and for the American farmer will only result in supply uncertainty and continued high prices. The domestic industry has historically supplied 70 to 75 percent of nitrogen fertilizers used by farmers in the U.S. with another 15 percent being supplied by nearby Canadian plants. Much like the natural gas market, this North American supply base was constructed to meet U.S. demand.

Offshore supply, on the other hand, was constructed to compete in a world market. In other words, offshore cargoes are sold and shipped to those markets that will yield the highest net back prices.

Further, an extensive distribution and storage infrastructure has been developed over the years to ensure that American farmers would have adequate supplies at the right time and at the right place. This system was specifically designed to move and handle large volumes of product from North American production sites to the major consuming areas. As a result, there is limited infrastructure to offload, store and transport larger and larger volumes of imports. This is especially true for anhydrous ammonia.

To replace the existing infrastructure with new facilities to handle greater volumes of imports would not only cost hundreds of millions of dollars but would also take considerable years to construct.

Nitrogen fertilizers are a fungible commodity, where market prices are set by supply demand conditions and therefore by the cash cost of the marginal producer. Under a continued environment of high natural gas costs the marginal supplier to the market will be the U.S. producer. Consequently, higher import volumes will not translate to lower prices to U.S. farmers.

In our opinion, high energy prices represent the most serious threat to the fertilizer sector and to farmers in general since the energy shocks of the 1970's. The fertilizer industry believes that it is essential that the U.S. develop a comprehensive and balanced energy policy, one that encourages the development of additional supplies and at the same time promotes the efficient use of a variety of energy sources rather than artificially encouraging the demand for natural gas over other fuels.

Again, Mr. Chairman, thank you for the opportunity to be here. Obviously this is a critical issue for our industry, and I would be happy to answer any questions.

[The prepared statement of Glen Buckley follows:]

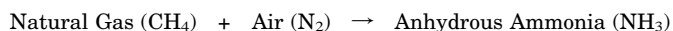
PREPARED STATEMENT OF GLEN BUCKLEY, CHIEF ECONOMIST AND DIRECTOR OF
AGRIBUSINESS, CF INDUSTRIES, INC.

CF Industries, Inc. (CF) is pleased to have the opportunity to present a statement on energy supply and demand issues affecting the agricultural sector of the United States. We welcome the opportunity to discuss how the current energy situation has affected the fertilizer industry over the last eight months and what we forecast the impact will be in the months to come. We strongly support the need for a comprehensive energy policy that focuses on adequate supply sources to aid strategic industries such as ours.

CF Industries is a farmer owned cooperative and is one of the largest nitrogen fertilizer producers and marketers in North America. We operate world scale production facilities in Donaldsonville, Louisiana and Medicine Hat, Alberta, Canada. CF and its Member cooperatives account for approximately one-fourth of the nitrogen fertilizers used in the United States and approximately one-third of the nitrogen fertilizer used in the primary growing areas of the Midwest. The Company also produces and mines phosphate fertilizers in Plant City and Hardee County, Florida. Through its nine member owners, CF's nitrogen and phosphate fertilizer products reach farmers and ranchers in 48 states and two Canadian provinces.

My purpose today is to discuss the devastating impact that the sharp rise in natural gas prices is having on both the fertilizer industry and on the American farmer. To fully understand the impact of increased natural gas prices on the fertilizer industry, a basic understanding of our products and production process is necessary.

Natural gas is the primary feedstock in the production of virtually all commercial nitrogen fertilizers in the United States. The production process involves a catalytic reaction between elemental nitrogen derived from the air with hydrogen derived from natural gas. The primary product from this reaction is anhydrous ammonia (NH₃). Anhydrous ammonia is used directly as a commercial fertilizer or is used as the basic building block for producing virtually all other forms of nitrogen fertilizer such as urea, ammonium nitrate, nitrogen solutions, diammonium phosphate and mono-ammonium phosphate. Natural gas is also used as a process gas to generate heat when upgrading anhydrous ammonia to urea.



Since natural gas is the only raw material used in producing nitrogen fertilizers, it is by far, the primary cost component. In fact, in the case of ammonia, natural gas accounts for 75 to 90 percent of the total cash cost of production.

Given this heavy reliance on natural gas, it is easy to understand the devastating impact that the recent rise in natural gas prices is having on the fertilizer industry. This can be clearly demonstrated by comparing natural gas costs, production costs

and U.S. nitrogen fertilizer operating rates over the last year and a half. In January of last year, natural gas prices at the Henry Hub were averaging \$2.40 per million Btu (MMBtu) and the cost to produce a ton of ammonia for a typical Louisiana producer was approximately \$100 per ton. At that time, the U.S. nitrogen industry was operating at approximately 90 percent of capacity. During the first half of 2000, natural gas prices began to steadily increase and by the end of June had increased to over \$4.00 per MMBtu. Production costs rose to almost \$170 per ton and the industry operating rate fell to 71 percent. Most of the natural gas consultants at that time thought prices had peaked.

Unfortunately, they were wrong. As everyone knows, natural gas prices began to soar during the second half of the year and by the end of December had climbed on a daily spot basis to over \$10 per MMBtu. Fertilizer production costs also soared to well over \$300 per ton. Not surprisingly, the industry was forced to shut down capacity with the industry operating rate falling to 57 percent in December and to a record low 47 percent in January. To put this into perspective, the average annual U.S. operating rate during all of the 1990s was 92 percent.

Natural gas prices have recently moderated somewhat from the record highs in December and early January. The lower prices have allowed the U.S. industry operating rate to move back into the 75-78 percent range. However, under today's natural gas prices, the industry is, at best, operating in a cash breakeven position with many plants running for the sole reason of meeting spring season supply commitments. Based on recent press releases and industry publications, the U.S. operating rate is likely to drop back into the 50-60 percent range by the end of June.

The sharp rise in natural gas prices and the resulting curtailment of U.S. fertilizer production has also had a dramatic impact on fertilizer prices throughout the marketing chain and, in particular, at the farm level. Nitrogen prices at the farm level jumped this year to record high levels. Based on a recent survey, the U.S. average farm level ammonia price, for example, has jumped to between \$385-\$400 per ton. This compares to an average of the last two years of \$219. Urea prices have also jumped from a two-year average of \$188 per ton to \$280 and UAN from \$129 to \$200 per ton. This translates into an increase in cost to a typical Midwest corn farmer of anywhere from \$15 to \$20 per acre.

Absent a substantial long-term reduction in natural gas prices, the U.S. domestic nitrogen fertilizer industry and, therefore, farm level supply, is at serious risk. Of the nineteen million tons of capacity in the U.S., approximately one million tons has already been permanently closed. According to an analysis recently completed by Blue, Johnson and Associates, another five million tons could possibly close within the next two to three years. In addition, it is anticipated that the remainder of the industry will likely operate on a "swing basis." That is, plants will only run when natural gas prices are low enough and/or fertilizer prices are high enough that producers can, at a minimum, cover their cash costs of production.

So what does all of this mean to the American farmer? To fully answer that question it is necessary to provide some additional background information. Since the 1940s when commercial fertilizers were introduced into the market on a large scale basis, farm demand for nitrogen fertilizers was always supported by a large, efficient, domestic fertilizer industry. During the 1990s, for example, approximately 70-75 percent of the nitrogen fertilizers consumed by American farmers was supplied by domestic production with another 15 percent supplied from nearby Canadian plants. The remaining 10-15 percent of the volume was sourced from offshore suppliers.

At the heart of the domestic fertilizer industry are production facilities designed to manufacture fertilizer products on a daily basis for the entire year. Many of these facilities are located near the source of raw materials but, far from the major consuming regions. Furthermore, it is important to note that most U.S. nitrogen fertilizer is consumed within a very short time frame in the fall and spring application seasons. As a result, an extensive distribution and storage infrastructure has been developed over the years to bridge this geographic and seasonal gap and ensure that American farmers would have adequate supplies at the right time. This system was specifically designed to move and handle large volumes of product from domestic production sites to the major consuming areas. Thus, the distribution and storage infrastructure is purposely integrated into the domestic production system to insure efficiency, economies of scale, and reliability of supply.

Under a scenario of continued high natural gas prices and further curtailments and closures within the fertilizer industry, U.S. farmers will likely be faced with increasing supply uncertainty and continued high prices. This year gave us a sense of the uncertainty to come. In December and January when the U.S. industry operating rate fell to record lows of fifty percent, it was evident that there would not be enough supply to meet farm level demand. This was despite the fact that the

U.S. production shut downs and increasing prices were attracting record volumes of imports. Fortunately, warmer than expected temperatures resulted in lower than projected natural gas prices. This allowed the U.S. industry to bring production back on stream and fill the potential shortfall in supply. It is clear that if natural gas prices had remained in \$8.00+ range in January and February, U.S. production would have remained curtailed and imports would not have been able to fill the void.

Longer-term, a scenario of continued high natural gas prices will undoubtedly lead to more U.S. plant closures, abandonment of marginally profitable infrastructure to rural communities, and increased imports. While higher volumes of imports could help fill part of the potential loss in U.S. supply, domestic production and distribution will have to remain viable to fully meet farmer demand. As I mentioned previously, the current distribution and storage system within the U.S. was constructed around a U.S. supply base. Consequently, there is limited infrastructure to offload, store and transport larger and larger volumes of imports. The lack of infrastructure is particularly apparent for anhydrous ammonia, which requires specialized tanks, pipelines, railcars and barges. Massive new investment and considerable lead-time will be needed if the existing infrastructure assets are left permanently stranded.

Increased reliance on imports would also result in a considerable increase in the potential for supply and price volatility. The vast majority of the U.S. industry was constructed to meet U.S. demand. Offshore supply, on the other hand, was constructed to opportunistically compete in a world market. In other words, cargoes are sold and shipped to those markets that will yield the highest netback prices. Imports are also subject to changes in world economic conditions, fluctuating exchange rates, and political and/or policy changes in other countries. A classic example of how policy changes in other countries can impact world markets occurred in April of 1997 when China banned all urea imports. Up until that point, China was by far the world's largest importer of urea. The world market was immediately thrown into turmoil. What China will do in the future is anybody's guess. However, a lifting of the ban could easily and suddenly tighten world markets and divert potential tonnage away from the U.S. market.

Increased U.S. reliance on imports will not result in lower prices for U.S. farmers. Nitrogen fertilizers are a fungible commodity product where market prices are set by supply/demand conditions and, therefore, by the cash costs of the marginal producer. Under a continued environment of high natural gas costs, the marginal supplier to the market will be the U.S. producer. Consequently, higher import volumes will not translate to lower prices to U.S. farmers.

From the standpoint of the American farmer, it is very important to recognize that a large percentage of the domestic nitrogen industry is owned and operated by farmer owned cooperatives. This includes almost 30 percent of the total U.S. ammonia capacity and approximately one third of the total U.S. urea and nitrogen solutions capacity. Further, it is estimated that approximately half of the total nitrogen fertilizers consumed in this country is moved through the farmer-owned cooperative supply and distribution system. Consequently, closure of the U.S. industry would directly impact farmers through their investment in the cooperative system as well as their ability to purchase product—particularly in remote, rural communities.

In our opinion, high energy prices present the most serious threat to the fertilizer sector and to farmers in general, since the energy shocks of the 1970s. The fertilizer industry believes that is essential the U.S. develop a comprehensive and balanced energy policy—one that encourages the development of additional supplies and, at the same time, promotes the efficient use of a variety of energy sources and technologies.

More specifically, the fertilizer industry supports a thorough review of those policies that severely restrict oil and gas production on multiple-use federal lands and large portions of the continental shelf. We believe that access to these reserves can be substantially beneficial towards meeting the nation's energy needs without compromising other legitimate interests.

In addition, the fertilizer industry also believes that it is imperative that a complete review be conducted of those policies and regulations that have artificially encouraged the demand for natural gas over other fuel technology for electric power generation. The tremendous delays and burdens involved in re-licensing hydroelectric power plants, vigorous EPA enforcement activities against coal-fired power plants, and the innumerable re-licensing and spent fuel storage issues associated with nuclear power plants, have left natural gas as the only practical fuel for new electric power generation plants.

The fertilizer industry believes that a balanced and comprehensive energy policy is not only long overdue, but also essential to the long-term viability of both the U.S. fertilizer industry and the American farmer.

Thank you for the opportunity to discuss these issues with you today. We look forward to working with you over the next few months and I would be pleased to answer any questions you may have on the fertilizer industry and natural gas pricing issues.

Mr. BARTON. Thank you, Mr. Buckley. Last but not least, we want to hear from Mr. John Duke, who is the National Director for Facilities Management for Kmart Corporation, and they are headquartered in Troy, Michigan. Your statement is in the record in its entirety. We ask that you summarize in 5 to 7 minutes, and we welcome you to the subcommittee. Are you going to give us a blue light special today maybe?

STATEMENT OF JOHN DUKE

Mr. DUKE. Thank you. Chairman Barton and the members of the committee, on behalf of Kmart Corporation, a national discount retailer with over 2,100 stores located in all 50 States plus Puerto Rico, Virgin Islands and Guam, and we employ over 20,000 people, with an annual sales of \$38 billion and with the International Mass Retail Association, IMRA, we thank you for granting me the opportunity to testify today.

Kmart Corporation is a member of IMRA, and as you may know, IMRA is the world's leading alliance of retailers, their product and service suppliers, and is committed to bring price competitive value to the world's customers.

I come before you today with 35 years of experience in the commercial energy field. My experience includes both the generation and delivery of power as a cogenerator of power at total energy plants throughout the western United States and the delivery of power at the Los Angeles Department of Water and Power plant operations. I have served on the Department of Energy's Education Advisory Committee and have developed and conducted energy classes and seminars across the country.

As Director of Facilities and Energy for Kmart Corporation, I have a unique perspective on how rising costs and frequent interruptions of energy supply have impacted customers and retailers alike. The rising cost of energy has greatly affected Kmart and has seriously hurt our bottom line. We have seen a significant increase in electrical costs in our stores in at least 10 States thus far and an increase of over 200 percent in gas costs in areas throughout the United States. We are preparing for potential rolling blackouts in New York and the Midwest this summer, depending on the temperatures.

In California, Kmart has been hit with rolling blackouts, and with these blackouts it costs us \$4,000 to \$5,000 per hour per store. During these blackouts most of the customers leave the store, costing us not only the prices of unsold merchandise that is left behind, but also significant labor costs to restock the merchandise on the shelves that are left in the carts.

Kmart has made important strides to conserve energy over the years and continues to make every effort possible to reduce energy costs. We are doing retrofits in 85 stores in California to reduce power. We have instructed stores to reduce sales floor lighting by

25 percent and have installed energy management systems to control lighting, heating, cooling setpoints. In addition, we are turning off electronic, administrative and display commitment and parking lot lights at night. We are recycling more cardboard and paper and plastics than ever before and have installed heating, ventilation and cooling replacement watt reducers and electric ballasts in our stores.

Through these efforts, we have reduced carbon dioxide by over 5,900 pounds, which is an equivalent of removing 597,000 vehicles from the road. We are proud of our efforts to conserve energy and reduce energy costs. However, as the summer months approach we are concerned that the continued pressure on both supply and demand will have a devastating effect in several regions of this country.

We commend the Congress and the administration for working to address the problem and are pleased to offer our input. As Congress debates a national energy policy, it is important to focus on both supply and demand issues. Several factors relating to supply and demand must be considered as a national energy policy is developed. These factors include increased transmission capability, creation of an independent reliability organization, a diverse fuel supply, energy efficiency and consumer protections.

While most of the focus on California's energy problem has been actual lack of generation, it must be realized that the transmission grid is as equally important. Legislation that addresses energy policy should encourage new transmission construction in order to keep up with the current demand, and utilities should be required to join a regional transmission organization.

As transmission capability needs to be improved, so does the reliability of delivering electricity to the customers. Consumers both large and small rely on uninterrupted delivery of service. To that end, we urge the creation of a new independent electric reliability organization with oversight from the FERC. This new organization should be tasked with developing and enforcing reliability rules and standards that would be required for all market participants.

Another issue which must be focused on is fuel supply. We would encourage that the focus on fuel supply be as diverse as possible. Congress should consider promoting alternative fuels such as coal and nuclear power and redouble its emphasis on increased investment in hydropower and renewable sources of energy.

It is clear that increasing the power supply alone will not help the Nation solve its current energy situation. We must also address demand side issues. We encourage the inclusion of energy conservation as an integral part of the Nation's energy policy. We applaud the Bush Administration for making efforts to reduce consumption in the Federal buildings in California, but this is only a start. We need to ensure that customers are encouraged to and given incentives to conserve as well.

Another priority in moving forward with a national energy policy should be protecting customers, both residential and commercial. As our experience in California has demonstrated, without protections against market power abuses, customers are hurt by exorbitant energy prices.

Other issues we would like to discuss are the proposals to repel the PURPA and PUHCA. The calls to eliminate both acts are understandable. The restrictions placed on the industry by these acts is costly and cumbersome. However, we believe that these restrictions are necessary only until the marketplace is completely competitive. Once true competition is realized we agree that these two acts should no longer be needed.

We also would like to take a moment to commend Chairman Barton for his efforts in helping to alleviate the terrible energy crisis in California through the introduction of H.R. 1647. This legislation draws significant attention to the problem in California. Now that the problem is crossing State lines, we believe additional emphasis must be placed on the role of the Federal Government, particularly FERC, in scrutinizing such prices.

I thank the committee for the opportunity to testify and would be happy to answer any questions that members and the committee might have.

[The prepared statement of John Duke follows:]

PREPARED STATEMENT OF JOHN DUKE, NATIONAL DIRECTOR OF FACILITIES/ENERGY,
K MART CORPORATION

Chairman Barton and members of the Committee, on behalf of Kmart Corporation and the International Mass Retail Association (IMRA), thank you for granting me the opportunity to testify today regarding an issue of tremendous importance to our country: our nation's energy supply and its transmission.

Kmart Corporation is a member of IMRA. As you may know, IMRA is the world's leading alliance of retailers and their product and service suppliers, and is committed to bringing price-competitive value to the world's consumers. IMRA improves its members' businesses by providing industry research and education, government advocacy, and a unique forum for its members to establish relationships, solve problems, and work together for the benefit of the consumer and mass retail industry.

As National Director of Facilities/Energy for Kmart Corporation, I have a unique perspective on how rising costs and frequent interruptions of energy supply impact consumers and retailers alike. The rising costs of energy have greatly affected Kmart, and have seriously hurt our bottom line. We have seen a significant increase in electricity costs in our stores in at least 10 states thus far, and an increase of 200% in gas costs throughout the United States. We are preparing for potential rolling blackouts in New York and the Midwest this summer, depending on the temperatures.

In California, Kmart has been hit with rolling blackouts, and when these blackouts occur it costs us \$4,000-\$5,000 per hour, per store. During these blackouts, most customers leave the store, costing us not only the prices of unsold merchandise that is left behind, but also significant labor costs to re-stock the merchandise that is left in carts.

Kmart has made important strides to conserve energy over the years and continues to make every effort possible to reduce energy costs. We are doing retrofits in 85 stores in California to reduce power; we have instructed stores to reduce salesfloor lights by 25%; and have installed energy management systems to control lighting, heating and cooling setpoints, which keep thermostats set at 75-77 degrees during the day and 80-83 degrees at night. In addition, we are turning off electronic administrative and display equipment and parking lot lights at night; we are recycling more cardboard, paper and plastic than ever before; and have installed heating ventilation and cooling replacements, watt reducers and electronic ballasts.

Through these efforts, we have reduced carbon dioxide by 5,907 pounds, which is the equivalent of removing 597,205 vehicles from the road; saving 818,086 trees (in terms of reduced carbon dioxide); and providing 319,765 American homes with sufficient electricity.

We are proud of our efforts to conserve energy and reduce energy costs. However, as the summer months approach, we are concerned that the continued pressure on both supply and demand will have a devastating effect in several regions of the country.

We commend the Congress and the Administration for working to address this problem and are pleased to offer our input. As Congress debates a national energy

policy, it is important to focus on both supply and demand issues. Addressing only one of the components will not solve the current energy problem facing our country. Several factors relating to supply and demand must be considered as a national energy policy is developed. These factors include: 1) increased transmission capability; 2) creation of an independent reliability organization; 3) a diverse fuel supply; 4) energy efficiency; and 5) consumer protections.

While much of the focus on California's energy problem has been the actual lack of generation, it must be realized that the transmission grid is as equally important, and it has also failed to keep pace resulting in increased congestion. Legislation addressing energy policy should encourage new transmission construction in order to keep up with the current demand, and utilities should be required to join Regional Transmission Organizations (RTOs).

As transmission capability needs to be improved, so does the reliability of delivering electricity to consumers. Consumers, both large and small, rely on uninterrupted delivery of service. To that end, we urge the creation of a new independent electric reliability organization with oversight from the Federal Energy Regulatory Commission (FERC). This new organization should be tasked with developing and enforcing reliability rules and standards that would be required for all market participants.

Another issue which must be focused on is the fuel supply. The Administration has talked a great deal about fuel supply and we have heard much about new drilling opportunities and attempts to decrease the reliance upon foreign sourced oil. As Congress moves forward, we would encourage that the focus on fuel supply be as diverse as possible, as reliance upon one source of fuel for electricity generation could lead to further problems. Congress should consider promoting alternative fuels such as coal and nuclear power, and redouble its emphasis and incentive base to increase investment in hydropower and other renewable sources of energy. While we are all aware of problems with the use of coal, I would urge the Administration and Congress to focus on the development of clean coal technologies. Coal is the least expensive and most abundant fuel source available today. With the looming increase in domestic gas prices, we must explore other options for fuel sources. Diversification will lead to more surety for consumers with regards to availability and price stability.

It is clear that increasing the power supply alone will not help the nation solve its current energy situation: we must also address demand-side issues. We encourage the inclusion of energy conservation as an integral part of the national energy policy. We applaud the Bush Administration for making efforts to reduce consumption in federal buildings in California, but this is only a start. We need to ensure that consumers are encouraged and given incentives to conserve as well.

Another priority in moving forward with a national energy policy should be protecting consumers, both residential and commercial. As our experience in California has demonstrated, without protections against market power abuses, consumers are hurt by exorbitant energy prices. In order to avoid these market power abuses, we urge that any company in the business of selling electricity, such as a generator or marketer, must be legally and functionally separate from any company in the business of providing transmission and/or distribution. This will help avoid conflicts of interest that create high costs for consumers.

Other issues we would like to discuss are the proposals to repeal the Public Utility Regulatory Policies Act (PURPA) and the Public Utility Holding Company Act (PUHCA). The calls to eliminate PURPA and PUHCA are understandable. The restrictions placed on the industry by these acts are costly and cumbersome. However, we believe that those restrictions are necessary only until the marketplace is completely competitive. Once true competition is realized, we agree that these two acts will no longer be needed.

We'd also like to take a moment to commend Chairman Barton for his attempts to help alleviate the terrible energy crisis in California through the introduction of H.R. 1647, the Electricity Emergency Relief Act. As California's energy problem spreads to other states in the region, your leadership is particularly appreciated. H.R. 1647 draws significant attention to the problem in California. Now that the problem is crossing state lines, we believe additional emphasis must be placed on the role of the federal government, in particular the Federal Energy Regulatory Commission (FERC), in scrutinizing the prices. The hardship this crisis has caused retailers and consumers would have been eased had FERC done more to ensure that consumers were not being overcharged by out-of-state suppliers.

As you are well aware, the main culprit in California's energy crisis is the wholesale price of electricity. This issue was not addressed in California's deregulation plan and is now affecting the energy situation in other western states. In addition to H.R. 1647, we believe it would be immensely helpful to include provisions ad-

addressing the wholesale price of electricity in California. Without addressing the problem of skyrocketing wholesale prices, California's serious problem will certainly move to other markets throughout the country at an accelerated rate.

I thank the committee for this opportunity to testify today. I would be happy to answer any questions that members of the committee may have.

Mr. BARTON. We thank you, Mr. Duke. Appreciate your testimony. We want to go on record that the committee is very interested in at least considering, if not repealing PUHCA and PURPA, but we are also on record for papa and mama in this subcommittee. So I just wanted to get that in the record before we do the questions.

The Chair would recognize himself for 5 minutes. Then we go to Mr. Boucher and Mr. Tauzin and then work our way down in order of appearance.

Mr. Anderson, you are clearly on record that gasoline prices are too high. What do you think your Association's position would be on an acceptable price for gasoline? What would a price per gallon be today that is acceptable?

Mr. ANDERSON. Well, I think if you look back at the averages over the last 3 years of \$1.26 a gallon and averages over the last 10 years of \$1.17 cents a gallon, I mean that puts us in the realm. I think given the prices today that probably the public would accept \$1.30, \$1.35. A couple of years ago that would have been seen as outrageous prices, but that would be 25 cents less than it is today per gallon. So, you know, it is all relative and certainly the outrageous prices we have got right now are, you know, changing the public's mind. I don't think anyone could have conceived of \$1.70 or—

Mr. BARTON. Less than 2 years ago or less than 1½ years I paid 79 cents a gallon.

Mr. ANDERSON. That is right. About 2½ years ago you could get gas not just in Texas but in the Washington, DC area for under \$1 a gallon.

Mr. BARTON. But that drove probably a million barrels of production a day out of the United States because the independents just couldn't—they couldn't stay in at \$7 a barrel.

Mr. ANDERSON. I was going to say, we understand under \$10 a barrel is certainly too low. On the other hand, \$38 a barrel last summer is way too high.

Mr. BARTON. If we had an energy policy that could adjust for inflation, give us gasoline prices at \$1.25, \$1.35, I mean that is not \$1 a gallon but it is less than \$1.75. So somewhere in that range would be—

Mr. ANDERSON. Yes, sir.

Mr. BARTON. Mr. Cook, you put a chart up on the easel when you were testifying that showed refinery capacity, availability and utilization, and I noticed that even at the beginning, which went back to 1981, we never showed refinery capacity of 20 million barrels a day in this country. Now, I am told that we are consuming about 20 million barrels of refined products a day in the United States. Do you think it should be a national policy goal to add 4 million barrels of refinery capacity in the United States to get us up so that we could be self-sufficient in refinery capacity?

Mr. COOK. Well, as a statistical agency I can't comment on what we should do and what might be desirable.

Mr. BARTON. You are a U.S. citizen. You have got a right to an opinion even as a citizen, and you are the only DOE witness we have got, such as you are. I mean, you are not a political appointee, but you know, you are it.

Mr. COOK. Well, I am not going to pick a number, but what I started to say is my testimony clearly indicates that tight refining capacity is adding to the high level of gasoline prices that we are looking at, and it does it in two ways. When stocks are low and we have refinery disruptions and prices rise, and especially now with very healthy refinery margins, there is absolutely every incentive to run flat out to resupply markets. So if you had more refining capacity you would reduce gasoline prices. You would probably limit the duration of the spike significantly.

Mr. BARTON. Well, let me ask you a question as a statistician. We have, and you can quibble with me on these numbers and feel free to quibble, but somewhere around 80 million barrels of world oil production today, crude oil production. Consumption is somewhere in that same order of magnitude between 78 and 80 million barrels a day. We are going to have a big debate on drilling in ANWR this summer, at least I hope we have the debate. I hope it is in the President's package, and I hope we engage in the debate.

The mid-case estimate for ANWR is that it would be a million barrel a day field for about 30 years. Does EIA have or could you run some price sensitivity models to tell us and tell the Congress and the country what an additional million barrels a day of production in the United States in ANWR, or anywhere else for that matter, would do when they flow through the retail price of gasoline based on the market as it is today?

Mr. COOK. Certainly. In fact, I can tell you what the answer would be right now.

Mr. BARTON. Oh, great.

Mr. COOK. Typically, when markets are relatively tight our models tend to indicate that every million barrel a day increase in supply over some reasonable length of time would tend to reduce world oil prices 3 to \$5 a barrel.

Mr. BARTON. Three to \$5 a barrel?

Mr. COOK. Take the \$4 figure, that is 10, 12 cents a gallon.

Mr. BARTON. Ten to 12 cents a gallon. So that is measurable.

Mr. COOK. Now, if you had a perceived or real increase of a million barrels a day and that is assuming—

Mr. BARTON. Well, it would have to be real. If it is perceived, it is not—that perception will fade when it doesn't show up in the market.

Mr. COOK. Absolutely, but as you know, markets work on perceptions, and at least if, for example, the markets were to anticipate an OPEC increase in the third quarter of a million barrels a day, yeah, if it didn't come forth then the markets would correct back, but anyway the point that I was trying to make is that simply the very near-term reaction to supply increases or decreases is not necessarily linear. It depends on the market conditions. So it might be larger or smaller.

Mr. BARTON. Now you said 10 to 12 cents a gallon based on a 3 to \$5 per barrel decrease. I have heard numbers on the retail side, the wholesale gasoline, double that, 20 to 25 cents. Is your es-

estimate that the accepted—the number I have been given—is that kind of an API provider pie in the sky estimate? Where would the median be? Would it be somewhere between 10 cents and 25 cents, or do you feel like the number you just gave us would be accepted by the economists around the country if we did a polling of all the economists that study these kind of things? And I am not setting you up. I just don't know because I had been told a little bit higher number than what you gave me.

Mr. COOK. Well, I haven't seen that other figure. All I can say is that when markets are in balance, when stocks are at normal levels, the supply elasticity is even less than the one I gave you. It is more like \$2 to \$3, which is an even smaller per gallon change. That is over a long period of time that we have compared price movements with supply changes both in and out of equilibrium. Again a larger figure like that, maybe double the 12-cent figure, 25-cent figure, might be that near-term reaction.

Mr. BARTON. Well, the reason I ask that is 2½ years ago when we had a surplus on the world market because of the softness in the Asian economy of between a half a million and a million barrels, the price just fell through the bottom. It fell down in Texas. West Texas Intermediate was about \$6.75 a barrel. Then when it tightened up and we got into a supply shortage of about a half a million to a million barrels a day the price went up, got up to like \$39 a barrel. So there really appears to be at the margin, when the markets don't know a real price elasticity, and any information that you could dumb down enough so that I could understand it, I would love to have because that will be useful in the debate.

Mr. COOK. Well, going back to 1998, the thing you need to bring into the comparison is stock levels. Because of an imbalance there that had been going on for a significant period of time, global crude product stocks rose to 10-year highs and when refiners, suppliers, traders can point—

Mr. BARTON. So it is a combination?

Mr. COOK. Yes, absolutely. When the world is flooded with crude and products, no one is going to pay very much. Those elasticities don't hold under those circumstances.

Mr. BARTON. Thank you. My time has expired. The gentleman from Virginia is recognized for 5 minutes.

Mr. BOUCHER. Thank you, Mr. Chairman, and my thanks to the witnesses for taking part in our conversation this afternoon.

Mr. Cook, in your testimony you talked about some gasoline market islands that exist because of various formulation requirements that are imposed for nonattainment areas and also that are imposed specifically in some other parts of the country for standards that are even above those that apply to nonattainment areas generally, and you specifically mention California and also the Chicago-Milwaukee area.

With regard to California, my understanding is that the State imposes special requirements for a lower sulfur content than is the norm nationally and also for a lower content with regard to carbon monoxide. So I think I understand what makes California special. What is not entirely clear is why the Chicago and Milwaukee area is special. Could you enlighten us a bit about why a market island is created in that area?

Mr. COOK. Well, there are a number of things. First of all, the fuel itself is unique in that it is blended not with MTBE like California but with ethanol, and one of the adverse consequences of blending with ethanol is it tends to raise vapor pressure. So this means that in order to conform to the stringent standards in the summertime, the reformulated blend stock has to intrinsically have a much lower vapor pressure and that is harder and more expensive to produce. In particular, only the half a dozen or so Chicago refineries normally produce that particular type of blend stock. Valero, for example, is one of the few in the Gulf Coast region that typically has the capacity to supply extra amounts to that market. There are very few that do. So if the market gets real tight for whatever reasons in that area, being at the end of the pipeline, being a unique and costly fuel just takes time, and the price signal is the incentive for other refineries to put together a batch and ship it up there.

Mr. BOUCHER. Is the Milwaukee-Chicago area the only place in the country where ethanol is required?

Mr. COOK. As far as I know, and that is not a national requirement. That may be, you know, a function of local conditions.

Mr. BOUCHER. And is the requirement in fact a local requirement or is it a local preference or what is the source of the decision that ethanol is used in the product there?

Mr. COOK. I am not even certain that it is an actual requirement. I think it just happens to be a function of the economics of the area.

Mr. SHIMKUS. Will the gentleman yield?

Mr. BOUCHER. I would be glad to yield.

Mr. SHIMKUS. I would as a Illinoisan and supportive of this line of questioning, I would say that as Illinoisans distrust and distaste for MTBE and the 2 percent oxygen standard required by the Clean Air Act and because we don't want the problems with MTBE we side with ethanol. I yield back.

Mr. BOUCHER. Well, if the gentleman would—if I could have the gentleman from Illinois' attention for just a moment, is it a feature of local law or is it merely a preference that has been announced and followed?

Mr. SHIMKUS. My staff is telling me it is both.

Mr. BOUCHER. Both. So it is a law which they prefer to follow?

Mr. SHIMKUS. Just being good environmentalists and protecting our groundwater, that is all.

Mr. BOUCHER. I thank the gentleman from Illinois.

Mr. Cook, let me continue to have your attention for a moment if I may. I am not familiar with your report that came out earlier this month on gasoline stocks, but I am told that the report suggests that stocks are now increasing as a consequence of refinery production domestically, plus the importation of refined product actually exceeding current demand. Is that correct?

Mr. COOK. Yes, sir.

Mr. BOUCHER. Now if that is true, why are we seeing prices for gasoline increase?

Mr. COOK. Well, actually you are not. If you look back over the last couple of weeks, wholesale prices and spot prices have dropped in some markets as much as 20 cents a gallon or more, and retail

prices typically lag the movements in wholesale 2 to 4 weeks. So if conditions don't change from those that we are looking at now with stocks building and supplies both from foreign and domestic sources rising, as I testified, we should start to see retail prices begin to drop by the first week or so in June. So as drivers hit the roads, the prices will still be high, and barring further major problems, they will probably drop just like they did last summer from June through mid-August. They dropped some 20 cents a gallon during the peak season and that is likely to happen again.

Mr. BOUCHER. So is it your conclusion that retail prices are either at their peak or nearing their peak at this point?

Mr. COOK. Yes, sir.

Mr. BOUCHER. And you do not anticipate prices going beyond approximately the current level for the balance of the summer driving season?

Mr. COOK. We are projecting possibly as much as another nickel or so over the next week or 2, but then beyond that it should stabilize and start to move down.

Mr. BOUCHER. Okay. Let me ask if you have any comment on the drawdown practices which both refineries and retail marketers engage in as they are converting from one seasonal blend to another seasonal blend. It has been suggested that the drawdown practice is used by some as a device to elevate price and that the drawdown occurs in a way that isn't strictly required by Federal law, but is used in effect to manipulate price. Do you have any comment on that?

Mr. COOK. I am not aware of any manipulation and I don't personally have the view that it is to raise prices. On the contrary, I think it is to minimize costs. Producing that summer grade, low vapor pressure gasoline is difficult and very expensive, especially for areas like Chicago. So there is a natural business reluctance to produce any more than absolutely necessary any earlier than absolutely necessary for fear of losing money on it. So you tend to cut it very close like in most other businesses.

Mr. BOUCHER. Okay. Thank you.

Mr. COOK. It works fine as long as everything holds up, you don't have refinery problems.

Mr. BOUCHER. Let me ask Mr. Duke one question and, Mr. Chairman, this will be my last.

Mr. Duke, I was encouraged to hear your comments with regard to PURPA in particular and I would like to ask you what we lawyers would call a leading question. Would you agree that until the retail electricity market is completely competitive that the current right that is provided under PURPA for the qualifying facility to interconnect with the grid and to buy power from the grid and under the right conditions to sell power into the grid should be retained? Could you speak a little louder, please?

Mr. DUKE. Yes, I do.

Mr. BOUCHER. Thank you very much, Mr. Duke. You are an excellent witness. Thank you, Mr. Chairman.

Mr. BARTON. I didn't get that question. Would you care to repeat it? It took about 3 minutes to ask. No, no.

Before we go to Mr. Tauzin, I just want the committee to know that the chairman of the subcommittee is a proponent of MTBE,

and we don't want to get into a debate about MTBE versus ethanol, but the gentleman from Illinois' statements are the gentleman from Illinois' statements and doesn't necessarily reflect the full will of the subcommittee nor do my statements for that matter.

Anyway, the gentleman from Louisiana, the full committee chairman, is recognized for 5 minutes for questions.

Chairman TAUZIN. I thank the chairman, and it is important that we do focus, first of all, on the situation that occurred in the Midwest last year. Last year when the price spikes hit and the shortages occurred, Chicago and Milwaukee were in trauma. The administration alleged, and I quote, market manipulation by big oil, and the Secretary of Energy, the Director of the EPA Carole Browner and then the head of the FTC, Mr. Pitofsky all testified here that they were going to chase down these big oil manipulators and find out what happened. Got a lot of national attention.

What didn't get a lot of attention was the report they issued when the studies and the investigation was completed. This is what they found: No evidence of illegal collusion to reduce output or raise prices. What they found was precisely what we discovered in that hearing, shortage of refining capacity and some real pipeline failures, combined with some administrative bungling as they moved from one fuel to another fuel.

Last week the FTC completed a similar 3-year study on western gasoline prices, following similar spikes and price problems in California and several of the western States. In a four to nothing decision the commission discovered no evidence that any refiner had the ability to profitably raise prices marketwide or reduce output at the wholesale level. In other words, they found no collusion either.

What they found is what you all have testified to generally, that we have got some real problems in our marketplace when we haven't built a refinery since 1976, and our pipelines occasionally fail us. In the Chicago and Milwaukee circumstance, two of the pipelines were running at 80 percent capacity under EPA's instructions because they had had some failures from problems with the pipelines.

So we have got, literally, some real problems in a marketplace that has trouble delivering the quantity of gasoline and natural gas that we need for our demand in this country. Production in natural gas dropped 14 percent since 1973, and yet 92 percent of the new electric generation plants are being built for natural gas, and we can't even operate our fertilizer plants in Louisiana. We can't make fertilizer for the farmers of America because the natural gas is all being diverted to a new electric generation facility. We have got some problems before this committee.

But I want to ask you, Mr. Cook, first of all, I was around here when we had a bigger problem than prices, when we had shortages, we had an OPEC oil embargo against America and when gasoline stations were running out of fuel, when we were parked in long lines waiting to try to get some fuel just to be able to go to work and go shopping. Americans were pretty upset then, but they understood that this was a bigger problem than the local refinery and the local gasoline station. This was international, OPEC shutting us down.

An interesting thing happened since then. We were about 35 percent dependent upon OPEC then. We are about 58 percent dependent on foreign sources today and OPEC has a much larger chunk of that, too. We are more dependent upon imported refined fuels than ever before, are we not, Mr. Cook?

Mr. COOK. Yes, sir.

Chairman TAUZIN. How much so?

Mr. COOK. Well, we are importing a couple million barrels a day now and I think that if we went back 10, 20 years—

Chairman TAUZIN. Minuscule.

Mr. COOK. Yeah, very substantially less.

Chairman TAUZIN. So our dependence is now growing on refined products, not just crude oil. How much more dangerous is that?

Mr. COOK. Dangerous?

Chairman TAUZIN. Yeah. I mean, suppose the people that were sending us refined fuels tomorrow wake up and decide if they get together and they are angry at the United States and just shut off sale of refined fuels to America, they could really wreck their economy, couldn't they? Could they?

Mr. COOK. Well, I think to cutoff the crude oil would have the same effect.

Chairman TAUZIN. But let's say they cutoff the refined products. Cut off the crude oil, we can buy crude oil from somebody else. That is what happened when OPEC shut us down. We started finding other supplies. Venezuela still supplied us. Mexico did. We found people who would give us crude oil. We had refineries to do the refining. We came out of that mess. But let's say if today that we are cutoff from crude oil, so we go find some more crude oil, but our refineries are not running at 100 percent capacity. What good will it do for us to go find some more crude oil? And if we run them at 100 percent capacity but we don't have this imported refined product coming in anymore, we could be in deep trouble, couldn't we?

Mr. COOK. Yes, sir. The only point I was making is that most of this product comes from Canada, from the Hess refinery in the Caribbean, from Venezuela. Some baseline comes from Europe as well as far as gasoline.

Chairman TAUZIN. So you think we can trust them by now?

Mr. COOK. I am not saying that. I am saying we don't get much refined product from OPEC.

Chairman TAUZIN. Does it make sense for our country to allow more and more of the refining capacity necessary to keep us supplied with a decently priced fuel to be located somewhere other than America? Is that good policy?

Mr. COOK. Again, I really can't comment on policy.

Chairman TAUZIN. I think the answer is obvious. I mean it is pretty obvious to me. I mean we look at refining capacity and we know that our refineries have tried to expand. They are under some real pressure now. If anyone tries to expand, they are going to run into a whole new set of EPA regulations. So they are questioning whether they should expand any more. We haven't built a new one since 1976. We are importing more than ever before. I am worried, as an American citizen, whether gasoline prices are just going to be high in the summertime, or whether they are going to

be high all year long. That is what I am worried about. I would be worried about whether we are going to have a day when long lines start forming again, because we have been so foolish as to rely upon everybody else in the world to send us their refined product.

And I want to talk about the fertilizer industry quickly.

Mr. BARTON. Quickly. Only because you are full committee chairman, chairman, and this witness is from your district.

Chairman TAUZIN. I will be real quick. A lot of people were unemployed in Louisiana when the plant shut down, right?

Mr. BUCKLEY. Yes, sir.

Chairman TAUZIN. So the first thing that happened is I start getting letters like this, Mr. Chairman, from workers in my district who are out of work today, who have been out of work since December because the plants can't operate because they can't get natural gas any more at a price that they can afford to operate. That is the first thing that happened. You know, the second thing that is going to happen, my buddy Mr. Shimkus is going to start getting letters from his farmers who can't grow the corn that has got to produce the ethanol that has got to go in those fuels in Chicago and Milwaukee because they can't afford the fertilizer to keep the corn growing out in the Midwest. We have got a ricocheting domino kind of thing going on here. We have just scratched the surface.

You see what happens in this country, people need to understand that, is the first unemployment shock hits Louisiana and Texas when the chemical plants have to shut down, and then the next shock hits when the fertilizer prices go out the roof, and the next shock hits when the refineries or anybody else goes down in Louisiana, and the gasoline prices go out the roof and AAA starts getting the kind of letters we get from constituents saying, hey, what is going on here, I can't take my family on a vacation anymore, the prices are eating us up alive.

And the worst of all thing happens——

Mr. BARTON. Worst than a chairman who is 4 minutes over his time?

Chairman TAUZIN. Worst than that. People in Massachusetts start running out of energy and then Mr. Markey starts getting the same kind of letters I am getting.

Thank you, Mr. Chairman.

Mr. BARTON. Gentleman's time has expired. The gentleman from Massachusetts, who has just seen a terribly bad example of going over time, is recognized for 5 minutes for questions.

Mr. MARKEY. Thank you, Mr. Chairman, very much.

Mr. Cook, we love having you here. You remind me of Sergeant Joe Friday; nothing but the facts, you know. So it is a tough role to play though, I understand, because all you want to do is lay it out the way the numbers indicate that it should without interpretation.

So the good news is, to recapitulate, that you believe that since the wholesale price has been dropping that we should begin to see within the next 2 to 4 weeks a lowering of the price of gasoline at the pump if every historical analogy holds up?

Mr. COOK. Barring any further major refinery problems.

Mr. MARKEY. Okay. Thank you. Now, Mr. Cook, on page 2 of your testimony you say, quote, actions taken by OPEC and several other crude oil exporting countries are largely responsible for the sharp increase in oil prices from the \$10 level that we saw in December 1998. OPEC dramatically reduced crude oil production in 1998 and early 1999, so much so that even after four production increases last year, inventories remain at extremely low levels. Now, how much did OPEC cut production in 1998 and 1999, Mr. Cook?

Mr. COOK. The three cuts essentially took about 3.5 million barrels a day off the markets at the peak.

Mr. MARKEY. Now last year you say OPEC made some production increases. When and how much did they increase their production?

Mr. COOK. Essentially the same 3.5 million.

Mr. MARKEY. Now, since January of this year, 2001, since the Bush-Cheney Administration took office in January, how much did OPEC cut production?

Mr. COOK. Well, they have cut quotas 2.5 million barrels a day, but they haven't cut absolute levels that much. It would be maybe half of that.

Mr. MARKEY. But their goal is to cut it and the signal they sent to the marketplace was they were going to cut 2.5 million barrels of oil a day.

Mr. COOK. Right.

Mr. MARKEY. This year. So they have cut half of that anyway, though?

Mr. COOK. Right.

Mr. MARKEY. Your testimony says that OPEC production cuts were largely responsible for increases in oil prices. Wouldn't you agree that if OPEC hadn't cut their production that consumers wouldn't be paying as much at the pump today?

Mr. COOK. Absolutely. OPEC has cut on an accumulated basis something like two billion barrels since 1998.

Mr. MARKEY. Now you are a dedicated Federal employee, so I am going to ask you this next question advisedly and you can be circumspect in the answer. Now Vice President Cheney has said that OPEC production cuts aren't to blame for today's high prices. He is just wrong on that, isn't he, Mr. Cook? Answer it in a very—with discretion, but accurately, please.

Mr. BARTON. I can help answer it if you need help.

Mr. COOK. By all means, be my guest.

Mr. BARTON. We want to give you first crack. It is only fair. We don't want to coach the witness.

Mr. MARKEY. I would rather have Joe Friday if you don't mind.

Mr. BARTON. But I am available.

Mr. MARKEY. Joe Barton we can get. Mr. Cook.

Mr. COOK. Mr. Cheney is correct to focus on refining capacity as one of the several factors that are underlying volatility here. My testimony also adds in low stocks and roots those low stocks in OPEC. It also talks about the fragmentation in the market and the fact that most of these major markets, that they are in the pipelines. So at least four factors there in some way contribute.

Now we haven't tried to quantify or say one is more important than another, but clearly they all interact together.

Mr. MARKEY. But your testimony says that the OPEC production cuts were largely responsible for the increases in oil prices?

Mr. COOK. Well, I was referring to the rebound from \$10 in December 1998 to the \$30 level that we have seen basically since 2000 for crude prices, right.

Mr. MARKEY. But the 2.5 million that has been taken off the marketplace, even if it is only half of that, has played a role, has it not, in the higher prices that we are seeing at the pump?

Mr. COOK. Well, absolutely. When you actually look at U.S. light high quality crude oil prices for the first 4 months this year, they are essentially the same as the first 4 months of last year.

Mr. MARKEY. Is it largely responsible for the price hike that we are seeing at the pump, as your testimony says?

Mr. COOK. No, I am not saying that. I am saying that continued high crude oil prices are continuing to elevate gasoline prices much like they did last year at the same period in time, but the low stocks, the limited refinery capacity and the fragmentation are adding their contributions to that volatility.

Mr. MARKEY. Okay. During the Presidential campaign last year, then Candidate Bush called on the Clinton Administration to call up OPEC and demand that they open up the spigots, and according to your testimony, OPEC actually increased their production last year, but in 2001 OPEC has cut production. If the administration had been successful from January on in this year and just not cutting back the production, how much of a difference would that have made in the price at the pump?

Mr. COOK. It is hard to say what would have happened. It is fair to say that OPEC production was very high in the fourth quarter and, despite that first cut in February, very high in the first quarter of this year. That coupled with some weakness in Asian oil demand, refinery and maintenance in each of the three major centers, there is some extra supply in the market over that period of time. In fact, we are seeing crude oil inventories here and elsewhere move into the relatively normal range.

The question is where do we go from here. Many think that as U.S., European and Asian refineries come out of maintenance and start running at higher levels for the peak summer period these crude stocks are going to go back down again. That is going to add pressure to gasoline and later on this fall to heating oil prices.

Mr. MARKEY. So even if the refining capacity is increased in the short term but the crude supply is not, that it still could result in a gasoline—

Mr. COOK. You have got to have both.

Mr. MARKEY. You have got to have both. Now let me just finish up here on a point.

Mr. BARTON. You are approaching the 2-minute over mark but we are giving you Tauzin time.

Mr. MARKEY. I don't need 20 minutes. I just need another minute or so. One of the things we keep hearing is there have been no refineries which have been added over the last 20 years. In fact, the number of refineries peaked at 319 in the year 1980, but isn't it also true that looking back to 1985 that there has been an increase

in refining capacity in the United States, even though we are down to only 158 refineries?

I am looking for an analogy here, Mr. Cook. What I'm thinking is, you know, you could say, well, there are fewer supermarkets today than there were 30 years ago so that must mean there is less food out there, if you want to ignore the Giants and the Safeways, you know, that displaced all these small corner market stores. It doesn't mean that there is less food. In fact, there could be more food if all the supermarket food is concentrated in a smaller number of stores, or all the oil refinery is concentrated in a smaller number of refineries.

Isn't that really what has happened over the last 15 years, that there has been a concentration increasingly in larger refining—refiners and refining capacity and expansion on that same location that enhances the capacity for refiners to produce products?

Mr. BARTON. Just to shorten the question, what is the refining capacity today versus what it was in 1985? How many millions of barrels per day are there now versus 1985?

Mr. MARKEY. I have the number from the Information Agency. There were 223 in 1985 producing crude oil distillation, 15,659—15 million, rather, to 15.6 million barrels. Today it is only 158 refineries; however, there is a crude oil distillation capacity of 16.5 million barrels.

Mr. BARTON. How much oil do we consume each day in the United States? I believe it is about 20 million, so you have about a 3.5 million barrel a day shortage of refinery capacity versus consumption in this country.

Mr. MARKEY. But as we know, Mr. Chairman, and I will finish up on this point, the refining industry itself had a surplus of refining capacity all the way up through 1999. And they did not anticipate this rise in the use of SUVs and the incredible Clinton economy which created 8 years of 32 percent growth in the economy. So because they didn't move quickly enough to expand their refining capacity on this private sector response, they underestimated what the refining capacity in our country would be missing the Clinton economic growth and the rise of the SUVs. They in fact thought they had a surplus all the way through 1999 and didn't really begin any expansion until then. And that is what every single economist in the United States has concluded as an analysis of the problem that we have today.

Mr. BARTON. You left out two statistics. 1985, the 15.6 million barrels per day refinery capacity was larger than the consumption. In other words, we were self-sufficient in refinery capacity in 1985. In 2000, we are not self-sufficient in refinery capacity. So if you have a bottleneck on your refinery runs, it does have almost an immediate spike that goes right through to the retail level. Now, those are the two statistics that you didn't put in: What was our refinery capacity versus our consumption in 1985, what is it today and how does some sort of a maintenance problem, how does that impact if you are relying on imports, which obviously take longer to get from overseas.

Mr. MARKEY. If I may just finish up. I had a document which rebuts conclusively that point which you just made, which comes from BP, in terms of their analysis of essentially the flat level of

refined product imports in our country over the last decade. And BP has done the analysis on that I would like to submit for the record——

Mr. BARTON. I am going to be——

Mr. MARKEY. Even though there has been an increase it has leveled off over recent years and in fact it is something that we live with quite comfortably, but the domestic refining industry did not respond themselves in terms of increased production capacity. With unanimous consent, I would like to put the BP study in.

Mr. BARTON. I think I have seen that study, but I will be happy to look at it. I don't see a reason not to put it in the record.

Mr. MARKEY. Thank you, Mr. Chairman.

[The information referred to follows:]

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The BARTON. The gentleman from Tennessee, Mr. Bryant.

Mr. BRYANT. Thank you, Mr. Chairman. Mr. Anderson, on behalf of the AAA you have testified in your written testimony today, perhaps too verbally, that many years of policy decisions focused on curtailing auto emissions and improving air quality, you testified in that statement as contributing to the current price spike in the gasoline. And I have heard different numbers, and Mr. Cook can help us on the numbers of these, what some people call boutique gasolines. Could you tell us what that term means to you? And you testified something about 14.

Mr. ANDERSON. 14 is our count. I don't know whether Mr. Cook has the same count.

Mr. BRYANT. I have heard it 50.

Mr. ANDERSON. Each urban area has particular problems and are required to use particular kinds of fuel for summer, for winter. And of course we have got eastern, midwestern, and western. So what certainly we are hearing from the industry is that there is an enormous problem meeting each of these kinds of fuels and so you are now getting spot shortages, as clearly has happened in the Midwest, especially last summer.

Mr. BRYANT. Pipeline broke down last summer, you just don't go to the next county and get gasoline. I don't know where you go. That is part of the problem. Mr. Cook, is that—do you have an approximate figure of these what we call boutique gasolines, these different recipes that are out there, how many different ones there are?

Mr. COOK. I think a dozen is probably the right number.

Mr. BRYANT. And obviously this affects the refining capacity, the refining ability of this country, this country's refineries.

Mr. ANDERSON. Absolutely. You can't just go out and produce one kind of fuel for summer use across the United States. There are various kinds. One of the things that we suggest in our testimony is looking to make the fuels more uniform, which would make the refining problem and the distribution problem easier.

Mr. BRYANT. I notice you did say that in your testimony. And my question would be to you what you recommend Congress do. That would be one thing. Are you talking particularly about the summer-winter mix or other types of—

Mr. ANDERSON. I am not a fuels expert, but it seems to me if we start with a dozen, or baker's dozen, and go from there and talk to the industry and say what is a realistic number that you can produce, that would effectively clean the air in America, because we don't want to lose that, but would also meet the needs of the various geography, West Coast and Midwest and East Coast, and the temperatures, the winter and summer needs.

Mr. BRYANT. Let me ask my Tennessee constituent, Mr. McCutchen, a couple of questions, if I could, in follow-up to your testimony. You had mentioned that Congress ought to try to build a fire under GAO, and I agree with you, to go ahead and get its study done before next winter so we can do something about it if there is anything we can do something about. And it was in the area of perceived price manipulation by some markets and commodities markets and so forth. But as I saw in your written testimony, you mentioned further inquiry into the role of the pipeline

capacity constraints as perhaps playing a role in the escalation of the natural gas prices. Could you mention that a little bit more?

Mr. McCUTCHEN. I was referring mainly to the California issue. In my opinion, the prices that the California market had to pay were not a supply problem, it was a transportation problem. And there was no way to segregate the supply versus the transportation, it was a bundled price. And I think that the Nation, the Nation's natural gas prices followed that market. I know they didn't follow them exactly. But when they would spike, everything would spike.

Mr. BRYANT. I know that has been in the news lately, too, but perhaps someone in California, maybe it was a legislative study that they did or something, seemed to confirm at least from California's viewpoint that this did occur in fact. Are you familiar with that?

Mr. McCUTCHEN. Yes. And I have seen it in other areas, just not to the extent that it happened in California. I mean, when you have got pipeline constraints, you know, and you have the capacity, you can put supply with it and deliver something that commands an extreme price in that situation.

Mr. BRYANT. Let me ask you another question, too. You alluded to this, but you testified in your written statement that you think that timely information is a big problem here and at EIA in their ability to forecast and produce numbers that would affect the markets and things like that. Generally, do you have further comments on that? You haven't had a chance to really talk about that today.

Mr. McCUTCHEN. Sure. Basically I mean, the EIA can only spit out the numbers as fast as they can. But where the problem I see it comes to is the marketplace, which is basically the New York Mercantile Exchange, has only one place to get a number and that comes out every Wednesday at 1 Central Time, and that is the AGA storage report. If that report comes out low, prices shoot through the ceiling. If it comes out high, they either flatten out or go down. You know, we didn't see until the end of the first quarter of 2001 that when you book the domestic supply versus the imported natural gas that came in that basically there was no shortage. I know of nobody that could not get natural gas if they were willing to pay the price unless it was a pipeline constraint.

Mr. BRYANT. Is there any—I mean how do you get more information? How can Congress help do that or how does EIA; are there other statistics and numbers and reports that would be helpful that are available? And that will be my last question.

Mr. McCUTCHEN. You know, I can't tell you how to do it. I just know that there are several areas that really concern me as far as what the Federal Government could do that I didn't discuss. And one of them is the CFTC, their control over the NYMEX, the New York Mercantile Exchange, and the futures market. We need to make sure that they have the tools to do what they are set up to do, and that is protect the people.

I think we also need to look hard at the Federal Regulatory Commission because they need the tools that they need to make sure that the pipeline capacity is there to deliver the product. And you know, I just want to reconfirm to you that this market is being driven on technical trading, not fundamental information. The fun-

damental information is hard to get because it takes time to get it and turn it around, but you know if the fundamental—the fundamentals were driving the market we would be in a \$2 natural gas price right now. We are still over 4 and headed back toward 5. It is just very important that we get timely information and correct information.

Mr. BRYANT. I thank you and I thank the other witnesses on this panel and yield back the time.

Mr. BARTON. The Chair would recognize the gentleman from North Carolina, Mr. Burr, for 5 minutes for questions.

Mr. BURR. I thank the Chair. It was interesting to learn earlier in the exchange that in one of the most robust economies for 8 years that there was zero attraction of the capital markets to new refineries, meaning one of two things existed, either there was not sufficient profits in refineries versus everything else that investments could be made in, or the regulatory burden perceived on refineries was so great that nobody wanted to invest in them. But the net result is that we have had no investment in refineries.

Let me move to you, Mr. Cook, and ask you a question relative to what Mr. Tauzin asked you. How much imported reformulated gas do we currently bring in from the country of Venezuela?

Mr. COOK. Thirty, maybe 40,000 barrels a day.

Mr. BURR. Which would be what percent?

Mr. COOK. We don't import that much finished reformulated gasoline. It will swing around a lot depending on stocks and the season, depending on demand.

Mr. BURR. The Venezuelans have a refinery there devoted just to the U.S. market for reformulated gas, am I correct?

Mr. COOK. Right.

Mr. BURR. I have seen that refinery. If that were to shut down and we got zero reformulated gas out of the Venezuelan refinery, what would that do to the U.S. supply?

Mr. COOK. It would depend on the time of year and stock levels. If stock levels are healthy, it would probably do very little. If stocks are low, especially on the East Coast, which is fed by that Venezuelan supply, then it would tend to raise prices a little, unless those imports are offset by Canada, Europe, whatever.

Mr. BURR. Walk me through a typical 12-month period of a refinery. At some point they are refining gasoline, at some point they are refining fuel oil. What other things would they refine out of that same refinery?

Mr. COOK. Heating oil, diesel fuel, the heavier fuels, the residual fuel oils, jet fuel.

Mr. BURR. In a 12-month period how long does a refinery need to be down for maintenance?

Mr. COOK. It depends again on the condition of the refinery, how much maintenance has been done the prior year.

Mr. BURR. We know that we haven't built any since 1976, so is the likelihood that they do need maintenance?

Mr. COOK. Oh, absolutely.

Mr. BURR. We had a policy where we asked the refineries not to go down for maintenance last fall because we were trying to get fuel oil into the system. And most of them did not, if I remember conversations you and I had in meetings upstairs. Was it predict-

able that refineries would go down at some point this spring for maintenance?

Mr. COOK. Certainly. All refineries eventually do weeks of refinery maintenance. If it hasn't been done in the fall, then typically you would expect to do it in the spring. I think what was talked about last fall, though, of refinery maintenance can be done and probably should be done when margins are low, when you are not foregoing healthy income. Typically during the shoulder months, the fall transition to heating oil and the spring transition to gasoline, margins are weaker so it is a good time to do maintenance. So I think the thought was, back then, with healthy refining margins, any unnecessary or discretionary maintenance that need not—

Mr. BURR. But knowing that they didn't go through maintenance and they would have to this spring, we could have with some predictability looked at the stocks and known we were going to have some problems. And I think there was a—

Mr. COOK. Sure. We know that and we have—

Mr. BURR. I am not suggesting that you didn't. I am just saying that had anybody read it, then they certainly would have been aware.

Let me ask you what you know about the royalty that all of the reformulated gasolines pay to Unocal? Are you familiar with that.

Mr. COOK. Yes, sir.

Mr. BURR. Is that 1 cent, 3 cents or 5.75 cents. I have seen three different figures.

Mr. COOK. Well, yeah, there are two different situations. The 1996 situation resulted in a royalty on a patent of 5.75 cents per gallon.

Mr. BURR. Isn't in fact that royalty on a patent that has nothing to do with the new fuel or a new additive but on the way the regulation was written, that they were able to patent off of that?

Mr. COOK. All I am saying is that the court found several West Coast refineries in violation of that situation and came up with that figure. Since then Unocal has offered to license U.S. refiners for anywhere from 1 to 3 cents a gallon.

Mr. BURR. We have spent a couple hours today talking about cents here and there. And I guess from an energy policy standpoint should we change the current regulation for reformulated gas so that Unocal can't take advantage of what seems to be a sweetheart deal where they have established the patent to the wording of the regulation? Should that be a consideration for us where we could take this royalty or licensing off the table?

Mr. COOK. Personally, although I will skip elements of that, I don't think the Unocal patent is a big issue right now. With margins as big as they are, a company doesn't have to worry a whole lot about 5.75 cents a gallon even if it gets tagged for it.

Mr. BURR. Let me ask Mr. Anderson. Do your members care about 5.75 cents a gallon.

Mr. ANDERSON. I think anything that could bring the price down below 1.70 or 1.75, or 2.29 I just heard in Chicago, would be helpful.

Mr. BURR. I think we are all in—

Mr. COOK. The only point I am making is if margins are 30, 35 cents a gallon as opposed to the normal 10 or 12, there is a lot of room in there for that 5.75 cents a gallon. That said, if margins are lower, clearly the risk, the uncertainty that is associated with that would tend to act as a disincentive.

Mr. BURR. I guess there are a lot of things I have run into up here that didn't make any sense. I am convinced they are there because nobody took the time to change them. This just looks like one of them. I am not suggesting that it makes a significant difference. Clearly we are here to talk about a little bit more than shaping an energy policy that could look out for a number of years and have a greater impact on probably the next generation than it does today. But with all the proposals that I have seen in the last 12 to 18 months, primarily that came out of the last administration, where we sold off reserve or we proposed to sell it off and started disputes within the Congress, if we had laid on the table then a proposal that would have taken 5.75 cents out of it there would have been a lot of people in this town that cheered. If in fact by changing the wording of a regulation we can relieve this noose that is around the necks of everybody else, it ought to be something that I think, Mr. Chairman, that we look at.

Mr. COOK. That 5.75 royalty or penalty is not being passed on to consumers right now. There is no evidence those prices, you know, are elevated to that degree as a result of that.

Mr. BURR. I have heard that excessive regulation is never passed on to consumers.

Mr. BARTON. I don't see how it couldn't be passed?

Mr. COOK. Well, technically any cost increase or tax increase or something like that is never passed totally on to consumers unless demand is perfectly inelastic. It is usually shared between consumers and producers.

Mr. BURR. Mr. Cook, let me suggest to you that any refinery that chooses not to refine formulated gas because they choose not to license or pay a royalty has chosen to do so, and the fact that they are not making reformulated gas increases the likelihood of a supply problem or a supply variation that causes the types of price spikes that Mr. Anderson and Members of Congress sort of cling to.

Mr. COOK. It is a disincentive to production. That wasn't at issue. I was just pointing out that 5.75 is a California finding only. The gasoline market in general is only a third RFG. Even if that entire penalty were passed on to California refineries' customers, which I don't believe is the case, it wouldn't have impacted the national average by that degree.

Mr. BARTON. I can say that I was in California over the weekend and I saw unleaded self-serve anywhere from \$1.93 to \$2.07 a gallon, so somebody is passing something on in California. I don't know what. I am paying a 1.52 in Texas and the 50 cents, 50 cents a gallon higher in California, it is not because Californians just have more money and decide they want to donate it to the sellers of gasoline.

The gentleman from Illinois, who has patiently waited, is recognized for the last 5-minute question round unless Mr. Markey has a final question.

Mr. SHIMKUS. Thank you, Mr. Chairman. I appreciate all the folks attending. That is what I really wanted to state. A lot of the questions dealt with—at least my colleague from Massachusetts was making the issue of imported crude oil versus refined product, and we had talked a little bit about OPEC and the effect that they have on the market. Let me ask just a very simple question. How do we escape the OPEC cartel? Mr. Cook, how would you propose we as a Nation escape the OPEC cartel?

Mr. COOK. Again, as a statistician, that falls——

Mr. SHIMKUS. No, it doesn't because let me explain. The basic economic principle of supply and demand, do you agree with it?

Mr. COOK. Sure.

Mr. SHIMKUS. That lower supplies would then reenforce higher prices, high supplies would in effect lower prices?

Mr. COOK. Right.

Mr. SHIMKUS. A crude oil cartel that is able to withhold production, limiting the supply, necessitates an increase in prices; is that correct?

Mr. COOK. Sure.

Mr. SHIMKUS. So, if we want to escape by a cartel from the crude delivery of oil from a region, what would an economist say? How—if you are being strangled by supply from one area, it doesn't matter if it is oil or Oreo cookies, how do you break away from the constraint of limited supply or decreased supply?

Mr. COOK. Well, I think many others have pointed out that, you know, OPEC is a cartel and does have considerable clout. One approach obviously is to expand crude production elsewhere. I think that point has been made to OPEC, that high prices, artificially sustained high prices will naturally encourage Caspian development and development in Canada, Mexico, around the globe, West Africa.

Mr. SHIMKUS. Would that also include the United States?

Mr. COOK. Absolutely.

Mr. SHIMKUS. We might want to solve the crude oil shortage by going after crude oil that is in the continental United States or even outside the continental United States to affect—I am just talking as an economist—the supply and demand equation?

Mr. COOK. I am saying I think the market forces will cause that to happen.

Mr. SHIMKUS. Unless there is an external force employed in keeping those available resources out of the ability to entrance into the supply chain, correct?

Mr. COOK. Yes.

Mr. SHIMKUS. Could be totalitarian governments in foreign countries, it could be environmental pressures that would affect our ability to get a million barrels of crude oil from ANWR a day for 30 years?

Mr. COOK. Yes, sir.

Mr. SHIMKUS. Thank you. Anyone want to add to that? I wanted really to address that to all of you, but I think the point is being made that we as a Nation have to have a diverse energy portfolio. We can't be constrained on one type of fuel source. We have a diversity of fuel issues here, not just crude oil. We have California

energy issues, we have got natural gas. Let me go to the point on the natural gas.

We have heard numerous testimonies on the California energy crisis. And Mr. Buckley, right, you are testifying on the agriculture side, and whoever else can address natural gas issues. Part of the problem in the California price spikes is the cost of the base product. Can anyone answer that question? Do they agree with that? Mr. McCutchen, you are reaching for the microphone there.

Mr. MCCUTCHEN. Would you repeat that question?

Mr. SHIMKUS. Part of the increased prices of generating electricity in California is a result of the natural gas prices, correct?

Mr. MCCUTCHEN. Correct.

Mr. SHIMKUS. Constant testimonies here before this committee indicate that California hopefully will meet their demand problems by July with three to five generating plants online. Do you know what fuel those three to five generating plants are?

Mr. MCCUTCHEN. I would bet you it is natural gas.

Mr. SHIMKUS. That would be a good guess. Mr. Cook, again just basically from basic economics, if there is high natural gas prices that are causing increased prices of generating electricity prices in California and you put on three to five new generating plants that are all natural gas to be fired up by July, what is the cost effect on the natural gas in California in July?

Mr. COOK. Well, it partly depends upon the strength of gas production. If one can assume—

Mr. SHIMKUS. Let's assume it stays the same, which would be a good guess between now—we are not going to have any new fields, we are not going to have any new pipelines developed at that time.

Mr. COOK. I think there is an expectation that gas production will grow a couple percent, between 2 and 3.

Mr. SHIMKUS. By July?

Mr. COOK. On a year over year basis. Each month we are going to see 2 or 3 percent more gas production than last year for the same point in time. So there is more gas to fuel more gas-fired plants, but I guess the question is will there be enough to avoid upward pressure on gas prices, and that is an open question.

Mr. SHIMKUS. But I think it is safe to say we will see an increased cost in natural gas if we have 3 to 5. Now, also before this committee it has been testified that by 2003 there is going to be 10 to 12 total generating plants in California. Anyone care to guess the fuel choice of the 10 to 12 additional plants? Mr. McCutchen.

Mr. MCCUTCHEN. Natural gas.

Mr. SHIMKUS. That is correct. And, Mr. Chairman, I see you are reaching forward. With this—

Mr. BARTON. We are giving everybody extra.

Mr. SHIMKUS. Is this Tauzin time or Markey time?

Mr. BARTON. Since Tauzin, everybody has been on Tauzin. We are almost pushing Markey now.

Mr. SHIMKUS. I don't want to belabor the point, but we have to have a diversified fuel portfolio. That diversified fuel portfolio needs to have many components. To my friends on the left, it does require new efficiencies, research and development, and we need to do that. But coal, nuclear, natural gas, crude oil, new refinery all

has to be part of the mix. If we don't have that, we are just kidding ourselves.

And that price will be passed on whether it is the price for the—as Mr. Burr pointed out, all prices and costs are passed on to the ultimate consumer at the end. You can bet on it—unless the business goes bankrupt, which will happen in some industries. We want to keep that from occurring. We need a long-term energy strategy.

I appreciate the hearing, Mr. Chairman. I yield back my time.

Mr. BARTON. We thank the gentleman from Illinois. Mr. Markey is recognized for one question.

Mr. MARKEY. I would just like to say to the gentleman from Illinois that we wholeheartedly subscribe to the notion that we don't want to depend upon one energy source. Coal is 51 percent of all electrical generation in the United States. We expect it to play the largest role in electrical generation for as long as you and I are alive. It will. All we disagree on, I think, is whether or not we want to allow them to emit CO₂ into the atmosphere the way they did 10 and 15 years ago. All we want is to burn coal cleanly. That is all we are debating over. That is the debate.

Mr. SHIMKUS. Would the gentleman yield for just 1 second?

Mr. BARTON. This was the last question.

Mr. SHIMKUS. But you can't clean CO₂. You can clean NO_x. The only way you can reduce CO₂ is by reducing fossil fuel usage. And I give back.

Mr. MARKEY. We believe on the Democratic side in clean coal technology, and in our legislation that we are proposing this week we fund clean coal technology. We don't want to abandon coal. But I think it is kind of fallacious to argue that gas is going to supplant coal. Gas is only 15 percent of all electrical generation in the United States. Every one of us will be in nursing homes before gas passes coal, as though there is some great threat that that is going to happen. If people are not investing in nuclear power, notwithstanding the fact that it already represents 20 percent of electrical generating capacity in the United States, it is because Republican Wall Street investment bankers have decided to invest in natural gas over the last 10 years.

Mr. BARTON. I am willing to recognize the gentleman for a question. I am not willing to recognize my good friend for a statement of somewhat rhetorical intent.

Mr. MARKEY. Okay. I was reaching a big point. The big point is, Mr. Cook, according to BP Amoco's analysis which I earlier submitted to the record, between 1990 and 1997 U.S. net refinery closures totaled some 34 sites in our country. They say that, quote, nearly all of them were very small and that the refineries closed averaged 30,000 barrels per day in capacity.

Weren't these refineries closed, Mr. Cook, largely because of the fact that they were economically inefficient, no longer could achieve the economies of scale needed to compete in today's markets, or were shut down as a result of mergers and consolidation in the oil industry?

Mr. COOK. Hard to disagree with.

Mr. MARKEY. Thank you. Now according to BP Amoco, production at existing refineries was increased over the decade by 1 million barrels a day. Is that consistent with EIA's assessment?

Mr. COOK. Capacity, did you say?

Mr. MARKEY. Capacity.

Mr. COOK. Yes.

Mr. MARKEY. Finally BP Amoco says that looking ahead, we expect U.S. demand growth for total oil and gasoline of 1.1 percent and 1.2 percent respectively, and that these growth rates are below the 10-year average and in our judgment can be met largely from expansions to existing U.S. refineries. That is BP, quote-unquote.

Do you agree or disagree with that assessment?

Mr. COOK. It is not inconsistent with our forecast; however, we are showing that going out 5 to 10 years refining capacity will be extremely tight.

Mr. MARKEY. But it is not inconsistent with what I have just said, that it is only going to be 1.1 percent to 1.2 percent?

Mr. COOK. I don't think anybody really knows. It is conceivable that refinery capacity could grow at roughly the same pace as demand.

Mr. MARKEY. The only point I am trying to make, Mr. Chairman, is that it wasn't environmental regulations that stopped the construction of the capacity, it is in fact the private sector, in many instances multinational oil companies, decision to not construct in the United States because clearly there is a refining surplus across the world. And here in the United States, for whatever reason, these multinationals have decided not to expand on location, but where there is going to be expansion it is likely to be on the same locations that have already been approved for refining capacity.

Mr. Cook.

Mr. COOK. Margins have been very low over the last 10 to 15 years, and that is the principal reason why we have seen sluggish capacity growth.

Mr. MARKEY. Then the question for us as Congressmen, should we guarantee a rate of return for private sector companies or should we allow the free market to work? That is a big decision for a committee. I am a free market man myself, but I can understand why many people on the Republican side like to intervene and use the government in the private sector to help them guarantee—be guaranteed profits. But I myself am a free market man. But I believe that ultimately the free market will respond, that the narrower the markets get the more likely they are to expand to meet demand, and we should wait for that to occur.

Thank you, Mr. Chairman.

Mr. BARTON. Well, now that we know that it is free market man Markey, we will—I will write a song about that for the next hearing. I wasn't going to ask any more questions, I was going to release the panel, but I do want—I don't strongly disagree with what Mr. Markey just said, but I want to tell the other side of the story. What is our refinery capacity today in this country, Mr. Cook?

Mr. COOK. 16.6 million barrels per day.

Mr. BARTON. What is our consumption of product in this country?

Mr. COOK. It ranges between 19 and 20 million barrels a day.

Mr. BARTON. But it is a larger number than the capacity number?

Mr. COOK. Yes, it is larger.

Mr. BARTON. So the assumption—it is not an assumption. The fact is to meet demand we are having to import more refined products than we did 15 years ago?

Mr. COOK. Yes, we are dependent on a half million barrels a day in gasoline alone on average.

Mr. BARTON. If we wanted to expand the existing refineries, as Mr. Markey has pointed out in a free market fashion, which I don't oppose, there is something at EPA called New Source Review; is there not?

Mr. COOK. Yes, sir.

Mr. BARTON. It is not an automatic. If I am Valero or Chevron or Exxon Mobil or British Petroleum, I can't just go out and increase that capacity. I mean, I have to go through the entire New Source Review permitting program to do that; isn't that correct?

Mr. COOK. Yes.

Mr. BARTON. And aren't those regulations fairly complicated? In fact, they are not even in existence yet because they haven't been promulgated after a 10 or 11-year effort to promulgate them; isn't that correct?

Mr. COOK. They are pretty stringent.

Mr. BARTON. Okay. I want to thank the witnesses. We wanted to get a consumer viewpoint and we certainly have from the AARP and AAA and our folks in the retail industries at Kmart and our bakery folks at the local level and a natural gas distributor from Tennessee. We appreciate you all for being here. As soon as the President puts out his energy package the day after tomorrow, we are going to do some more hearings and then try to put together some legislation to have affordable energy for all Americans in an environmentally acceptable fashion. So we appreciate your testimony, look forward to working with you this summer.

This subcommittee is adjourned.

[Whereupon, at 3:37 p.m., the subcommittee was adjourned.]

[Additional material submitted for the record follows:]

TENNESSEE ENERGY
May 16, 2001

The Honorable ED BRYANT
United States House of Representatives
408 Cannon House Office Building
Washington, DC 20515-4207

Re: May 15 Hearing Entitled "Consumer Perspectives on Energy Prices"

DEAR CONGRESSMAN BRYANT:

I want to thank you for inviting me to testify at yesterday's hearing before the Subcommittee on Energy and Air Quality, and I also wanted to thank you for your kind introduction and your excellent opening statement. It was a new experience for me, and a most interesting one. Also, I want you to know how much I appreciate your heroic efforts to fly back from Tennessee in time to attend the hearing. Personally, and on behalf of Tennessee Energy and all of its member systems, I am grateful for the continuing interest you have shown in getting to the bottom of the reasons for high natural gas prices and ensuring that everything that can be done is done to protect gas consumers. I will be sure that all of my member systems hear from me personally about your efforts.

One of the questions you asked me during the hearing concerned the portion of my written testimony addressing the need for better and more timely information from the Energy Information Administration (EIA). After thinking about your ques-

tion overnight, I wanted to answer it more fully. If you think it is appropriate, I would ask that you include this additional response in the hearing record.

I see at least three basic problems that I was trying to address about the lack of meaningful factual information in the marketplace. First, there is the problem of not having enough hard data, timely enough for the market to be able to absorb it and use it. An example of this is the lack of concrete information on production until months after the fact. That is a basic problem, but it is hard to know what to do about it.

Second, there is the problem that, since the market does not have the type of timely information about supply and demand that it should have, it looks to “proxy” information—like the storage inventory information that I referred to in my written testimony and in my answer during the hearing—that does not actually convey information about the level of supply or demand; but then the market uses it as though it did. So as a result of not having more hard data on supply, we end up seeing the market use “proxy” data that may actually be sending false information signals.

Third, there is the problem of EIA putting out information that may not be true. If EIA does not have hard data on production, EIA should not be making statements that production is down, for example. EIA cannot know that production is down unless it is basing that statement on actual production data. As I pointed out in my testimony, the actual data for 2000 show that production was up in 2000, but EIA put out statements during 2000 that production was down, providing support for, and perhaps fueling, the market perception that there was a supply-demand imbalance. What EIA says in its Monthly Outlooks and its other publications is taken as fact, precisely because EIA is designed to be a statistical, information-providing agency, not a policy-making agency. So EIA should not be making pronouncements based on its own assumptions about what is happening in the market. It should restrict its statements to those based on the data it has. That is different from EIA stating, for example, that it is projecting that supplies will increase or decrease.

An example of what I am talking about is EIA’s statement that supply is down in the year 2000 because storage inventories were low. EIA did not know that supply was down. EIA presumed that supply was down based upon its reliance on storage numbers that I believe were better explained by factors having nothing to do with supply levels, but rather everything to do with price, as I pointed out in my written testimony. Mr. Cook, in one of his answers to a question from one of your colleagues, specifically recognized that perceptions have an important effect on market prices. EIA should not be adding to perceptions.

Once again, thank you very much for inviting me to testify at the hearing, and for your continuing interest in this issue. I look forward to working with you in attempting to expedite the GAO investigation, on the proposed legislation entitled “Municipal Utility Natural Gas Supply Act of 2001” that I referred to in my testimony, and on other matters involving natural gas. If there is anything that I can do to assist you in any way, please do not hesitate to call on me.

Sincerely,

J. MARK MCCUTCHEN
President and General Manager

cc: The Honorable Joe Barton
Jay Bush, Legislative Assistant